

**U.S. PATENT AND TRADEMARK OFFICE
OPERATIONS AND FUNDING**

HEARING
BEFORE THE
SUBCOMMITTEE ON COURTS, THE INTERNET,
AND INTELLECTUAL PROPERTY
OF THE
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U.S. PATENT AND TRADEMARK OFFICE OPERATIONS AND FUNDING

THURSDAY, JUNE 7, 2001

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS, THE INTERNET,
AND INTELLECTUAL PROPERTY,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 2 p.m., in Room 2141, Rayburn House Office Building, Hon. Howard Coble [Chairman of the Subcommittee] presiding.

Mr. COBLE. Good afternoon, ladies and gentlemen. The Subcommittee will come to order. First of all, I will apologize. It looks like it will only be Mr. Berman and me today. We are finished with work on the floor, so I suspect our Members very likely are on their way to the airport. But Howard, it is good to have you here. We will do the best we can with the two of us. He said he considered heading for the airport early.

Today we will review the operations of the Patent and Trademark Office. It pains me, and I am not being dramatic when I say this, but it pains me that the focus of our hearing, as it has been in the past, will be the continuing problem of diversion of Patent and Trademark Office funds from the agency to other government programs. More specifically, by the end of the present fiscal year the agency will have lost more than \$600 million attributable to diversions, rescissions, and other budgetary sleights-of-hand.

Our witnesses understand how this harms PTO operations and ultimately how it can harm that sector of our economy that is dependent on the creativity of inventors and trademark owners. I pledge that our Subcommittee will work in a bipartisan manner with those in the intellectual property community to do whatever is viable and necessary to reverse this trend.

Along these lines, witnesses and the Subcommittee may wish to critique three legislative responses to the funding problem which have been introduced in the present Congress.

This is not to say, however, that we are extending a free pass to the Patent and Trademark Office. All of us in the public sector must be accountable for our work product. So the Subcommittee will be interested in evaluating those aspects of agency operations which must be improved to serve the needs of individuals and businesses which file for patent and trademark protection in Crystal City.

In this regard, I am especially concerned about ongoing problems within the Patent and Trademark Office governing its automation and computer systems.

I look forward to the testimony of the witnesses here this afternoon, and now I am pleased to recognize the distinguished gentleman from California, the Ranking Member, Mr. Howard Berman.

Mr. BERMAN. Thank you, Mr. Chairman, and thank you for calling this hearing. It is another installment in our annual review of the PTO and its operations.

In its work examining and granting trademarks, the PTO plays a critical role in spurring technological innovation and commercial creativity. This innovation and creativity in turn has been the primary engine behind our information economy. By and large, the PTO is to be commended for doing excellent work. As with any entity, there is room for improvement at the PTO.

I have been concerned about the quality of some patents being issued, particularly business method patents. I believe there are a variety of ways the PTO can address these quality concerns. However, many solutions to quality concerns will remain outside the PTO's grasp unless it has sufficient resources to implement those solutions.

The Bush administration's budget request for fiscal year 2002 planned to divert 207 million in fiscal year 2002 PTO fees to programs outside the PTO. While revised revenues estimates from the PTO indicate that the actual diversion may be far less than the 207 million in this coming fiscal year, the Bush budget also proposes to divert an average of over \$180 million in succeeding years.

This, as the Chairman likes to call it, is legalized larceny, far outstripping anything contemplated by previous administrations. I think it is appropriate to categorize these fee diversions as a tax on innovation. This innovation tax takes fees paid by inventors and business people to secure patents and trademarks and uses them as interest free loans to fund unrelated programs. Now, when they are programs I like I am less upset about that. But as a general principle it is really a questionable activity.

And it is slightly ironic that an administration, pardon my next sentence, Mr. Chairman, but it is slightly ironic that an administration so intent on cutting taxes and promoting free enterprise would build on and increase such an enormous tax and innovation. This innovation tax is leaving the PTO unable and unequipped to perform its very critical mission. Over the past few years patent and trademark applications have skyrocketed. At the same time patent and trademark pendency has lengthened unacceptably. Ideally the PTO would respond by streamlining the application process and increasing the number of examiners, but without adequate funding the PTO has been forced to defer needed improvements in their IT infrastructure and withstand record attrition in their work force. Talented people can go and do go elsewhere when the government cannot pay competitive salaries. Without sufficiently talented people, average workload goes up. Pendency increases and quality suffers.

I believe Congress should repeal this innovation tax by ensuring the PTO can use all its fees it receives.

The Chairman mentioned several of the pieces of legislation. Representative Boucher and I introduced H. Res. 110 several months ago to accomplish this very goal. It would create a point of order against floor consideration of any bill that provides the PTO with less than full funding. The Chairman, Representative Conyers and I introduced a bill yesterday which also advances the goal of legislating full PTO funding, H.R. 2047. That bill authorizes the PTO to use all the fees it collects in the fiscal year 2002. I believe that H.R. 2047 and H. Res. 110 are symbiotic and I will pursue House passage of both.

I want to be clear about the difficulties inherent in any attempt to legislate full funding. Without significant sustained support from affected PTO users, the prospects for repeal of the innovation tax are dim. I applaud all the efforts we have already seen, but coalition letters and trade association lobbying must be coupled with direct appeals from the CEOs, more grass roots involvement and expansion of the organizations involved. The PTO also has a substantial role to play in enabling its supporters to effectively advocate for the repeal of this innovation tax. The PTO needs to clearly and specifically outline how it would use all the diverted fee revenues. While more money will certainly help the PTO fulfill its mission, additional funds cannot fix all patent quality concerns. There are a variety of forms, particularly within the examination process, which would significantly improve confidence in patent quality.

The statement I seek to put in the record would expand on some of those points, but I wanted to just address one of the reforms included in H.R. 2047. Currently the PTO can accept electronically filed patent applications but then examines these applications in hard copy. Such a system not only creates unnecessary administrative costs but also effectively prevents pending applications from becoming a useful source of prior art. H.R. 2047, the Chairman's bill that I am supporting, would require the PTO to establish a system that allows it to electronically process, maintain and search patent applications. Such a system could allow an examiner of a business method patent application to scour all pending applications for prior art. As applications currently outnumber business method patents actually granted, pending applications could become a fruitful source of prior art.

I will yield back the balance of my time, Mr. Chairman, but thank you again for having the hearing.

Mr. COBLE. Without objection, your entire statement will be made a part of the record.

Howard, I think your term "taxing innovation" is probably less severe than "legalized larceny," but I think both are accurate. I take no umbrage from my friend about the administration. It is true. This diversion, as you all know, is a bipartisan attack. I don't like the Bush approach, I didn't like the Clinton approach. And Howard and I, Mr. Berman and I fought the other administration; we are going to fight this administration hopefully to eliminate this diversion. I know you all are getting tired of hearing us talk about this, but it is a severe problem that needs to be resolved, and we will continue to talk about it and hopefully resolve it.

The Subcommittee is pleased to have as our first witness the Honorable Nicholas Godici, who serves as Acting Undersecretary of

Commerce for Intellectual Property and Acting Director of the United States Patent and Trademark Office. Mr. Godici has a long and distinguished career at the PTO, serving in several key management subcommittees, including his tenure as the Assistant Commissioner for Patents and Trademarks.

Mr. Godici received a Bachelor of Science in mechanical engineering in 1972 from the Pennsylvania State University and earned a graduate level certificate of advanced public management from the Maxwell School of Citizenship and Public Affairs from Syracuse University in 1998.

Our second witness is Nils Montan, Vice President and Senior Intellectual Property Counsel at Warner Brothers, a division of Time Warner Entertainment Company, and he is testifying on behalf of the International Trademark Association in his capacity as the INTA President. Mr. Montan has been a member of the adjunct faculties of the law schools at the University of Southern California in Los Angeles and Loyola University. He is also the author of a recent monograph on trademark counterfeiting published by INTA, called Trademark Anti-counterfeiting in Asia and the Pacific Rim.

Mr. Montan received his B.A. from Cornell University and his J.D. from the Washington College of Law at American University and an L.L.M. from the University of Virginia School of Law.

Our third witness is Ronald E. Myrick, who serves as the President of the Intellectual Property Owners Association, IPO, and is Chief Intellectual Property Counsel for the General Electric Company. Mr. Myrick holds a juris doctor cum laude from Loyola University of Chicago School of Law. Prior to assuming his present position, he was an attorney in private practice. Mr. Myrick has been nominated by the United States to the World Trade Organization Dispute Settlement Roster and has served as a Delegate for IPO in meetings of the Committee of Experts for the Protocol and the Patent Harmonization Treaty. He is also a member of the USPTO Patent Public Advisory Committee. And Mr. Myrick, I want to say to you and to Mr. Herb Wamsley and others, I want to extend kudos to you for a very fine Inventor of the Year reception that we conducted earlier this week in the Cannon Caucus Room. That was a very fine event, and I thank you all for the work you did to make that happen.

Our final witness this afternoon is Mr. Ronald J. Stern, who is President of the Patent Office Professional Association. Mr. Stern holds a Bachelor's Degree from the City College of New York and a law degree from the George Washington University. He has worked as a primary examiner at the PTO since 1964.

We have written statements from all the witnesses on this panel, which I ask unanimous consent to submit into the record in their entirety. I ask that each witness, folks, if you can, confine your remarks as we have previously requested to on or about 5 minutes. When you see the red light illuminate in your eye, that does not mean that Mr. Berman and I are about to attack you physically, but it is a warning that it is about time to wind down if you can do that within the 5-minute time frame.

Mr. Godici, why don't we start with you?

**STATEMENT OF THE HONORABLE NICHOLAS GODICI, ACTING
UNDERSECRETARY OF COMMERCE FOR INTELLECTUAL
PROPERTY AND ACTING DIRECTOR OF THE U.S. PATENT
AND TRADEMARK OFFICE**

Mr. GODICI. Thank you, Mr. Chairman. I want to begin by thanking you and Ranking Member Berman and the other Members of the Subcommittee for your continued strong support of the USPTO and effective protection of intellectual property in the United States and internationally.

As the Subcommittee is well aware, the USPTO is experiencing significant increases in patent and trademark filings that present important operational challenges to our office. In fact, since 1996, patent and trademark filings are each up over 50 percent.

To manage this rapidly increasing workload and provide first-rate service to our customers, the USPTO is pioneering a number of e-government initiatives. In the last year we have implemented electronic filing of patent applications, expanded electronic filing of trademark applications, and completed our online Web database to include every U.S. patent ever issued back to the very first patent in 1790.

My written testimony highlights the many awards our e-government initiatives have received. Other events of note in the last year include the issuance of our final "Utility Examination Guidelines" for determining the utility of inventions, a groundbreaking ceremony for our new consolidated headquarters in Alexandria, and publication of a report in the USPTO's capacity as co-chair of the National Intellectual Property Law Enforcement Coordination Council concerning ways to improve government's role in IP law enforcement.

On the international front we continue working with other national industrial property offices to streamline the procedures for securing protection for patents, trademarks and copyrights. As the effective protection of intellectual property rights becomes an increasingly focus of worldwide trade the demands for our office's expertise in this area is growing significantly.

Let me now discuss our patent and trademark operations in greater detail. In fiscal year 2000 the USPTO received over 291,000 utility patent applications, an increase of 12 percent over the previous year. We granted a record 182,223 patent documents and hired 375 new patent examiners. Due in part to the strong competition from the private sector, however, we lost 437 of our examiners. The USPTO is managing to the AIPA's 14-4-4-4-36 timeliness standards which provide restoration of a patent term to diligent applicants when certain requirements are not met by the USPTO.

In fiscal year 2000, 81 percent of the applications received a first Office action within 14 months or sooner.

End-of-year pendency to first office action averaged 13.6 months, better than what we projected, which was 14.2 months.

Other noteworthy developments included a 30 percent improvement in patent quality in the first half of this fiscal year, based on our internal quality review program, and a reduction in patent examiner turnover from the 14 percent last year mainly as a result of approval just in the last week by OPM for a special pay scale for our patent examiners.

Mr. Chairman, I want to take the opportunity at this point in time to stop and thank Ron Stern, the President of our Patent Examiner Union, and the members of his team for working very closely with us to bring about that special pay scale for patent examiners at the USPTO.

On the trademark side we received a record 375,000 trademark applications last year, a 1-year increase of 27 percent. This rate of increase has declined significantly this year in tandem with the economic slowdown and we currently project an 18 percent reduction in filings this year compared to fiscal year 2000. Last year we registered over 127,000 classes and increased our work force on the trademark side to 383 trademark attorneys by hiring 74 new attorneys.

Trademarks is aggressively utilizing information technology and the Internet to better serve its customers, with a goal of all communications with customers being electronic by 2003. The filing of trademark applications via the Internet, a key part of this initiative, now stands at more than 22 percent of the total applications filed. Other noteworthy developments in trademarks include a reduction in first action pendency to 5.6 months, its lowest level in 8 months, and a drop in trademark examining attorney attrition from 13.2 percent at the end of last year to 8.6 percent currently, and the expanding of our popular work at home program, which now includes more than 90 of our trademark examining attorneys.

On the budget side, Mr. Chairman, for fiscal year 2002 the President has recommended that we be given the authority to spend \$1.139 billion of the fee revenues that we expect to generate. This is an increase of \$100 million, or 10 percent over the fiscal year 2001 enacted level.

Although the President's budget assumed that we would collect \$1.346 billion, we have had to revise our fee collection estimates to reflect the decline in trademark application filings and fewer requests for early publication of patent applications. Our current 2002 fee collection estimate is \$1.218 billion. Of that amount, \$857 million will be available to us in fiscal year 2002. In addition to that amount, we will have access to \$282 million carried over from fiscal year 2001, for a total of 1.139 billion.

My written testimony provides details on our fiscal year 2002 funding priorities. In conclusion, Mr. Chairman, the work of the USPTO is critical to the economic vitality of our Nation. I am confident that the USPTO can continue to lead the world in providing customer-valued intellectual property rights that spark innovation, create consumer confidence and promote economic growth. We look forward to working with you and all the Members of the Subcommittee in doing just that.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Godici follows:]

PREPARED STATEMENT OF NICHOLAS P. GODICI

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to discuss the operations and funding of the United States Patent and Trademark Office (USPTO). At the outset, Mr. Chairman, I want to thank you, Ranking Member Berman and the members of the subcommittee for your continued strong support of our office and for effective global protection of intellectual property.

As the Subcommittee is well aware, intellectual property is at the forefront of the news. Indeed, in light of the rapid growth in patent and trademark filings, our agency faces a number of important operational challenges. With sufficient resources, I am confident that the USPTO can meet these challenges and continue to lead the world in providing customer-valued intellectual property rights that spark innovation, create consumer confidence, and promote creativity.

The USPTO has experienced significant increases in patent and trademark filings in recent years. Patent application filings are currently 13 percent above last year's level; since 1996 they are up over 50 percent. Although trademark filings are currently down 18 percent from this time last year, filings are over 50 percent higher than in 1996.

The USPTO has undertaken a number of significant initiatives over the last year to provide our customers with more efficient, high-quality service.

We are a leader in providing e-government services. Within the past year we have implemented electronic filing of patent applications for all of our customers, expanded electronic filing of trademark applications through our Trademark Electronic Application System (TEAS), and expanded our on-line patent Web database to include every U.S. patent ever issued—back to the very first patent in 1790. I am pleased to report that our e-government initiatives have been very well received. Our Patent Electronic Business Center, which includes our Electronic Filing System, was selected last November as one of the year's "Best Feds on the Web" by GovExec.com, the website of *Government Executive* magazine. "Patents on the Web" was recognized by the Smithsonian ComputerWorld Laureate program as one of the five best government projects in the world for 2000. TEAS has received several national awards, including its recent recognition as a finalist in the 2001 Quality Cup Award sponsored by *USA TODAY* and the Rochester Institute of Technology in New York. Our website (www.uspto.gov) receives over 30 million visits each month and was recently named to *Entrepreneur Magazine's* Third Annual "Top 100 Best Sites." USPTO received the E-Gov 2001 "Trailblazer" honorable mention award for its efforts to promote innovative Electronic Government programs.

Let me highlight some other noteworthy accomplishments for the USPTO over the last year.

In January, after extensive public comment, we issued our final "Utility Examination Guidelines" for determining the utility of inventions. While the guidelines are applicable to all areas of technology, they are particularly relevant in areas of emerging technologies, such as gene-patenting. Also, earlier this year, we held a groundbreaking ceremony for our new consolidated headquarters facility in Alexandria, Virginia, and, as co-chair of the National Intellectual Property Law Enforcement Coordination Council, we provided a report to the President and Congress focusing on areas in which interagency coordination could improve the Government's performance in IP law enforcement.

Our Patent and Trademark Public Advisory Committees, which include independent inventors, lawyers, corporate executives, small entrepreneurs, and academicians, have met on several occasions since their establishment last summer. Pursuant to the American Inventors Protection Act of 1999 (AIPA), the Committees published an annual report late last year assessing the performance, goals, and policies of the agency. Also pursuant to the AIPA's pre-grant publication provisions, the USPTO on March 15, 2001, published the first patent applications. We expect that over the next eighteen months the number of published patent applications will increase to a weekly rate in excess of 4,000.

On the international front, the USPTO continued working with other national industrial property offices to streamline the procedures for securing protection for patents, trademarks, and copyrights. For example, nearly a year ago, our work with the World Intellectual Property Organization (WIPO) resulted in the United States and 42 other member states signing the Patent Law Treaty. Once the Treaty enters into force, uniform patent filing requirements and formal procedures among the Treaty's member states will help reduce the cost of securing patent protection abroad. In addition to this achievement, our policy specialists in the Office of Legislative and International Affairs engaged in multilateral and bilateral negotiations to strengthen IP protection worldwide and provided technical assistance to strengthen international IP enforcement. The USPTO has taken the lead in developing country-specific, interagency enforcement training initiatives for China, Mexico, and Oman, and sponsored or cosponsored more than a half dozen IP enforcement programs for government officials and private sector interests in Asia, Eastern Europe, West Africa, and the Americas. As the effective protection of intellectual property rights becomes an increasing focus of worldwide trade, the demands for our Office's expertise in this area are growing significantly.

Let me now discuss our patent and trademark operations in greater detail.

PATENTS

In fiscal year 2000, the USPTO received 291,653 utility patent (patents for invention) applications, an increase of 12 percent over the previous year. Some of the largest increases in patent filings are occurring in the areas of business methods and biotechnology. Last year we granted a record 182,223 patent documents, including 164,490 utility, 16,719 design, 453 plant, 561 reissue patents, and 88 statutory invention registrations. Utility patent grants in fiscal year 2000 represent a 15 percent increase over the total for fiscal year 1999.

To handle the increase in our workload, the USPTO hired 375 new patent examiners last year. However, we lost 437 examiners due, in part, to the strong competition from the private sector. Although we lost ground in terms of the staff necessary to process our incoming work, our end-of-year total examining staff was 2,959, up from 2,212 in fiscal year 1997. Most of the new examiners are assigned in our software, computer, business methods, and biotechnology areas. They have an average of four years of practical experience in those industries and some fifty percent have advanced degrees, including a number of Ph.D.s.

As you might expect, the impact of the AIPA on our Patent operations is profound. The AIPA provides stringent processing times as benchmarks. The USPTO is managing to the "14-4-4-36" timeliness standard which provides commensurate restoration of a patent term to diligent applicants when the following requirements are not met by the USPTO: (1) issue a first Office action on the merits within 14 months from the filing date; (2) respond to an applicant's reply to a rejection or appeal within four months of receipt by the Office; (3) act on an application within four months of a decision by the Board of Patent Appeals and Interferences or the federal courts; (4) issue a patent within four months from the payment of the issue fee; and (5) issue a patent within 36 months from the filing date.

In fiscal year 2000, 81.2 percent of applications received a first Office action within 14 months or sooner. End-of-year pendency to first Office action averaged 13.6 months, better than the projected target of 14.2 months.

Other noteworthy developments in Patents included:

- Our traditional internal measure of Patent Quality, based on the error rate in a sampling of allowed applications, improved 30 percent from the end of last fiscal year. A combination of in-process reviews and technical and legal training efforts has contributed to this improvement.
- USPTO management signed an agreement with the Patent Office Professional Association (POPA) concerning a special pay request and the removal of paper-search files. Called the "Millennium Agreement," it provides that, contingent upon approval of a 10 percent special pay request for patent examiner and related positions, POPA agrees to the phased removal of paper-search files, a work-at-home pilot project, and a customer service element in employees performance plan. This agreement addresses a number of issues that will help the organization move forward, including enhancing retention and recruitment efforts, moving from a paper-based to electronic-based search system, and helping customer service and quality improvement efforts. The Office of Personnel Management approved the special pay rate just last week.
- Patent examiner turnover improved from 13.8 percent in fiscal year 2000 to 9.0 percent in the first half of fiscal year 2001. A factor likely contributing to this decrease was the anticipation of the special pay rate approved by the Office of Personnel Management.

TRADEMARKS

Much like the activity in patents, the trademark side of our operations also experienced significant growth in fiscal year 2000 when we received a record 375,428 trademark application classes, an increase of 27 percent over fiscal year 1999. This was the second year in a row that we received a 27 percent increase in trademark application filings. This rate of increase has declined significantly this year in tandem with the economic slowdown, and we currently project an 18 percent reduction in filings this year compared to fiscal year 2000. We registered 127,794 classes and increased our workforce to 383 by hiring 74 examining attorneys. As a result, trademark pendency to first Office action has improved over the first half of this fiscal year.

To ensure that we make our operations as efficient and user-friendly as possible, Trademarks is utilizing information technology and the Internet to better serve its customers. By reducing or eliminating the number of processing activities in the production process, with end-to-end e-processing of trademark applications, we

have the greatest potential for performance improvement. Trademarks' goal is to have all communications with our customers handled electronically by 2003.

The filing of trademark applications via the Internet—a key part of this initiative—increased 8 percent in the first half of fiscal year 2001 to more than 22 percent of total applications filed. We expect our 100,000th Internet-filed trademark application to be filed shortly.

In fiscal year 2000, Trademarks also opened its first e-commerce law office for the examination and processing of electronically filed applications for trademark registration. The Trademark e-commerce law office is based on the success of electronic filing of trademark applications and is consistent with the e-Government strategy to do business electronically. The creation of this e-commerce law office demonstrated the opportunity for reducing the length of time it takes to register a mark. As the number of electronically filed applications increases, the USPTO will convert more law offices to e-commerce offices.

Other noteworthy developments in Trademarks included:

- First action pendency fell to 5.6 months at the end of March, its lowest level in 8 months. The estimated end-of-year (EOY) pendency to first action will be 4.8 months.
- The attrition rate among Trademark examining attorneys fell from 13.2 percent at EOY fiscal year 2000 to 8.6 percent in the first half of fiscal year 2001. This drop in attrition is partially attributable to a number of initiatives implemented in the first half of fiscal year 2001 to enhance employee satisfaction.
- Trademarks embarked on two distinct initiatives to stimulate productivity: (1) implementation of a semi-annual incentive award of up to \$10,000 for increased productivity, and (2) expansion of the Work-at-Home program.
- The Trademark Work-at-Home program, which began with 18 trademark attorneys in March 1997, now includes more than 90 examining attorneys working from home three days a week.

BUDGET

For fiscal year 2002, the President has recommended that we be given authority to spend \$1.139 billion of the fee revenues we expect to generate. This is an increase of \$100 million or 10 percent over the fiscal year 2001 enacted level. This level would support the fiscal year 2001 staff levels which include 2,950 patent examiners and 393 trademark attorneys, in addition to special pay raises and performance bonuses for these employees.

The fiscal year 2002 President's budget assumed we would collect \$1.346 billion. Since submitting the budget, we have revised our fee collection estimates to reflect the decline in trademark application filings and the reduced levels of requests for early publication of patent applications. Our current 2002 fee collection estimate is \$1.218 billion.

Of the \$1.218 billion in revenues we expect to collect next year, \$857 million will be available to us in fiscal year 2002. We will seek use of the remainder, \$361 million, for fiscal year 2003. In addition to the \$857 million, we will have access to \$282 million carried forward from fiscal year 2001—for a total of \$1.139 billion.

Fiscal year 2002 funding would be used for the following priorities:

- \$43.8 million for what we call "adjustments to base." These include amounts to cover cost of living pay increases and other inflation costs.
- \$32.5 million to provide special pay rates to enable the recruitment and retention of patent professionals. The quality of patent examination will improve by having a stable and more experienced workforce.
- \$17.7 million to fully implement the pre-grant publication provision of the AIPA.
- \$6.2 million to provide a financial incentive for higher workload productivity in the Trademark business. This performance incentive award is included in the agreement between the National Treasury Employees Union (NTEU) chapter 245 and the USPTO which was ratified last December. The addition of this productivity award program provides Trademark Examiners with the ability to increase their take-home pay while the USPTO and its customers benefit from increased productivity and quality.

CONCLUSION

Mr. Chairman, as I mentioned at the beginning of my remarks, the USPTO faces a number of important operational challenges. We have made good progress toward

meeting those challenges, and we look forward to working with you and the Subcommittee, other interested members of Congress and the Administration to ensure that we have sufficient resources, financial flexibility, and appropriate oversight to meet those challenges and provide first-rate service to our customers.

Thank you.

Mr. COBLE. Thank you, Mr. Godici.

Mr. Myrick, in a sense of fairness Mr. Godici had about almost 2 minutes over, so we will give you 7 minutes as well and then you won't be penalized for that, Mr. Godici.

STATEMENT OF RONALD E. MYRICK, CHIEF INTELLECTUAL PROPERTY COUNSEL, GENERAL ELECTRIC CAPITAL SERVICES ON BEHALF OF INTELLECTUAL PROPERTY OWNERS (IPO)

Mr. MYRICK. Thank you, Mr. Chairman. And a very good afternoon to you and to you, Mr. Berman. I appreciate the opportunity to testify today on behalf of the Intellectual Property Owners Association, known as IPO. The views I am expressing today are those of IPO and not necessarily those of General Electric, Patent Public Advisory Committee, or the bar associations with which I am associated.

Speaking for IPO, I am speaking for owners of IP. Our members include about 100 American corporations that are among the largest patent filers in the United States and worldwide from all major industries.

I first want to compliment the employees of the PTO for working diligently to improve the office in very difficult circumstances. But they can only do so much with the funding that they have.

Mr. Chairman, the PTO is likely to be in a crisis soon if it is not already there. According to the PTO's fiscal year 2002 corporate plan, the pendency time of the average patent application in the PTO will rise to 38.6 months by 2006. The prospect of American companies and inventors waiting 38.6 months on average to obtain a patent, which means 40 to 50 months in many cases, is entirely unacceptable. Such delay will drive companies and inventors away from using the patent system and have a commensurate effect upon innovation in this country.

Timely processing is vitally important for many industries, but timely processing is only part of the picture. Equally important, if not more so, any plan for recovery by the PTO must focus on improving the quality of patent and trademark examination. To undertake a program for improving patent quality, we recommend that the PTO publish the best objective standards of quality it can articulate after a thorough study of the subject with input from the public.

The PTO should measure its quality against these standards regularly and publish the set of indicators of quality of patent search, and examination for each of the seven technology centers.

An improved feedback mechanism should be established to drive the processes within the patent system, to reach specific goals for patent quality, which should be reviewed each year by the Subcommittee. In industry we refer to this kind of approach to quality as Six Sigma, or statistical process control, because it focuses on controlling the processes that result in patents driving out the root causes of mistakes and errors from those processes.

In addition, the PTO needs more funds for investments and information technology systems, about which Mr. Godici just spoke. The e-filing systems are receiving much attention at the PTO at this time. But improvement and expansion are essential for both patent and trademark registration applications throughout the entire processing mechanism.

We recognize that the Members of this Subcommittee have long fought for adequate funding for the PTO. We are encouraged that the officials of the incoming administration; namely, the Secretary of Commerce, who have been looking into the PTO are also looking at what the office needs, emphasis on the word "needs."

The practice of withholding fees paid to the PTO by the patent and trademark applicants and owners is the primary cause of the situation in which the PTO now finds itself. According to the President's budget, by the end of 2002 the amount of, quote, unavailable collections, end quote, will be \$871 million. Whatever that means, unavailable, permanently through rolling artful accounting or unavailable only temporarily is unclear.

The solution to the funding problem is to provide the PTO with the resources it needs to do its job, even if the PTO needs an amount greater than that now being collected. The time when an amount less than fee collections can even be considered is past. Rather, the discussion now should be retrieving past withheld fees for use now, not at some unidentified future availability date.

Therefore, we endorse H.R. 2047, introduced this week by Chairman Coble and cosponsored by Mr. Berman and Mr. Conyers, which authorizes 2002 PTO funding, authorizes special funding for electronic filing and processing, and requires a 5-year strategic plan.

As an alternative to asking the appropriations committees each year to appropriate adequate funds for the PTO, Congress could enact Chairman Coble's bill, H.R. 740, or Mr. Berman resolution, H. Res. 110, to eliminate the authority of the appropriations committees to withhold PTO fees. We support these measures as good solutions for the future.

In summary, to turn around the current situation, the PTO needs the hundreds of million in, quote, unavailable collections. If these fees have not been diverted actually to unrelated government programs, or used for deficit reduction, but are only being truly temporarily withheld, they should be used now to address the critical problems facing the PTO.

If they are permanently unavailable, through a rolling accounting artifice or otherwise, they are gone and have been used for other purposes, that should be made clear.

Thank you for the opportunity to speak to you today.

[The prepared statement of Mr. Myrick follows:]

PREPARED STATEMENT OF RONALD E. MYRICK

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to testify today on behalf of Intellectual Property Owners Association (IPO). I am the current President of IPO. I am also Chief Intellectual Property Counsel for General Electric Co. in Fairfield, Connecticut; I have the privilege of serving on the U.S. Patent and Trademark Office's Patent Public Advisory Committee "P-PAC," as First Vice President of the American Intellectual Property Law Association, and on the Council of the IP Law Section of the American Bar Association. However, the views I am presenting today are those of IPO and

not those of my company, the P-PAC or any bar association. Speaking for IPO, I am speaking for Owners of IP rights.

IPO is an association of U.S.-based owners of patents, trade secrets, trademarks, and copyrights. Our members include about 100 American corporations that are among the largest patent filers in the United States and worldwide from all major industries. Our members file about 30 percent of the patent applications that are filed in the U.S. Patent and Trademark Office (PTO) by U.S. nationals, and pay nearly \$200 million a year in fees to support operations of the PTO.

PATENT AND TRADEMARK OFFICE IN CRISIS

The effectiveness of PTO operations is of great importance to U.S. companies and inventors. As the members of this committee know, proper functioning of the patent system also is very important to the economic strength of the country. The patent system when operating properly encourages invention, innovation and business investment. Effective administration of the Federal Trademark Act by the PTO is equally important. It encourages business investment and protects consumers.

IPO has testified at many of the annual PTO oversight hearings before this Subcommittee. We always emphasize the need for 1) conducting a high quality professional examination of patent and trademark applications, 2) processing patent and trademark applications promptly, and 3) streamlining and modernizing PTO operations so as to increase efficiency and provide the best overall service to the public. These fundamental objectives for the PTO have not changed, but this year the PTO seems to be in more danger of failing to meet these objectives than at any time in memory. Unfortunately, the PTO is starving for lack of funding.

We want to compliment the employees of the PTO for working diligently to improve the office and its operations in the current very difficult circumstances. As a member of the P-PAC for the past year I have personally had the opportunity to witness the commitment of PTO employees at all levels in the office. But they can do only so much with the funding they have.

Mr. Chairman, "crisis" is a strong word. We do not want to exaggerate, but the PTO is likely to be in crisis soon if it is not there already. According to the PTO's "Fiscal Year 2002 Corporate Plan," the pendency time of an average patent application in the PTO will rise to 38.6 months by 2006. The prospect of American companies and inventors waiting an average of 38.6 months to obtain a patent is unacceptable. Many patents and many technologies likely will far exceed this average. Such delay would cause enormous uncertainty about legal rights in new technology and discourage investments in the inventing, developing and marketing of new products and services. Delays of this magnitude also will result in automatic extensions of the life of most patents under the American Inventors Protection Act. This is inconsistent with the Congressional decision that patents should generally expire 20 years after filing.

If this is not enough to justify using the word "crisis", we have learned that the European Patent Office is considering a cutback in searching and examining patent applications filed under the Patent Cooperation Treaty that may throw additional workload to our PTO. Although we do not know the effects on the workload and revenue of the PTO, this could represent an additional threat to the effectiveness of the U.S. patent system.

IPO believes the time has come for a special PTO recovery program. We have no doubt that the PTO can meet the goals—high quality patents and trademarks, reasonable pendency time, and implementation of "e-government programs"—if funding is available. If funding continues at recent levels, it cannot. That is a crisis for U.S. industry and inventors. Our members are very concerned, so much so that two weeks ago 61 corporations including many IPO members wrote to members of the Commerce, Justice, State Appropriations subcommittees on this subject. A copy of that letter is attached.

PROCESSING DELAYS

The estimated patent pendency time of 38.6 months in 2006 is more than double the long-time goal of disposing of applications within 18 months and nearly a 50 percent increase over the current pendency time of about 26.2 months. Last year there were 257,000 patent applications awaiting examiner action. By 2006 the PTO Corporate Plan projects 1,293,000 patent applications will be awaiting examiner action.

Indeed the 2002 PTO Corporate Plan actually presents an optimistic scenario from one perspective, because it bases its future pendency time projections on the assumption that after 2002 the PTO will be allowed to spend as much money as it collects in fees each year through 2006. That is a prospect the PTO has not en-

joyed since 1991, but such an assumption is inconsistent with a document published by the Office of Management and Budget in April which assumes withholding an average of \$184 million a year from the PTO through 2006. Thus, the full fee funding assumption underpinning the basis for even this dismal projection on pendency seems to be questionable without strong Congressional action.

In reality, without a drastic change in the policy for funding the PTO it appears the future will be even dimmer than shown in the Corporate Plan. In view of past funding constraints, the PTO has been unable to hire enough patent and trademark examiners for several years and now its base of experienced examiners is too small to catch up with its workload for years even if it were given a massive cash infusion tomorrow. We have then a recipe for a major problem that will take years and reliable, steady, significant funding to fix.

PATENT AND TRADEMARK QUALITY

Processing time is important, but it is only part of the picture. Any plan for recovery by the PTO also must focus also on improving the quality of patent and trademark examination and insuring development of effective electronic systems for filing and processing of patent and trademark applications, to improve efficiency, reduce costs and improve public service for the future. The PTO must have the resources needed to produce high quality patents for all industries. The need for patent quality is discussed most often in connection with emerging areas such as business method patents, on which this Subcommittee held a hearing on April 4, 2001. Resources are needed to insure high quality business method patents, but resources are also needed to insure high quality computer software patents, electrical patents, chemical patents, pharmaceutical patents, biotechnology patents, and brick and mortar patents.

To undertake a systematic program for improving the quality of patent examination, we recommend the PTO develop and publish the best objective standards of quality that can be articulated after a thorough study of the subject with input from the public. The PTO then should measure its quality against these objective standards on a regular basis and publish the results. Such a system of objective quality standards should be used to drive improvements in patent quality. While the PTO has published some information on its quality review program, we feel that more objective standards can be established.

We note that the Subcommittee recently approved legislation to improve patent reexamination proceedings in the PTO. IPO supports improvements in patent reexamination proceedings to give the public a reasonable opportunity to test the validity of patents without expensive court litigation. However, patent reexamination is not a substitute for a thorough prior art search and application of patent law standards to every application by PTO examiners before the patent is granted. The PTO is doing a good job with the resources available, but, again, only so much can be done with current resources.

INFORMATION TECHNOLOGY

In its Corporate Plan the PTO needs more funds for investments in information technology systems. The Corporate Plan states:

The solutions for managing a large inventory of pending applications cannot solely rely on hiring of additional personnel. We must also make critical investments in information technology systems and redesigned processes if we are to manage future workloads.

Because of the scarcity of funds at the PTO, we believe the PTO has had to forego information technology investments to focus instead on processing current workloads. Unless the PTO obtains more resources it will be unable to avoid future delays in investing in electronic systems that could strengthen its ability to handle its workloads.

The e-filing system for trademarks at the PTO has proven very effective. Indeed, within less than an hour, GE's Corporate Trademark Office filed 53 applications earlier this week. Although the system eliminates a three-month delay from the time of filing to the time of receiving a mailed filing receipt, there is still room for increased efficiency as the system does not yet allow for all communications between the PTO and its trademark customers to be done electronically. Still, its ease of use is far greater at the moment than the Electronic Filing System (EFS) for patent applications. The patent e-filing system is the focus of substantial attention in the PTO at this time and its improvement and expansion are vital links in the essential elimination of paper in the proceedings of the PTO.

THE IMPACT OF WITHHOLDING PTO USER FEES

The members of this Subcommittee are well aware that Congress and the Executive Branch have been withholding a portion of the user fees paid to the PTO by patent and trademark applicants and owners each year. The practice of withholding fees is the primary cause of the situation in which the PTO now finds itself. Withholding began in 1992 with relatively small amounts each year, and has increased to the point where it has created a funding crisis. According to the President's budget, the amount of "unavailable collections" will be \$871 million by the end of 2002.

Based on the funding recommendation and workload projections in the President's budget when it was submitted in April, \$207 million would be withheld next year out of \$1.346 billion in fees paid by U.S. companies and inventors for PTO services in 2002. The amount of withholding has been increasing through a bookkeeping scheme in which each year a portion of previously withheld money is said to be made available, but a larger amount of current year collections is withheld. For example, in the President's 2002 budget, it is proposed that \$282 million ". . . from fees collected in prior fiscal years shall be available for obligation in fiscal year 2002. . . ." and that \$489 million of 2002 collections will be "precluded from obligation." Hence, the net withholding of \$207 million.

It is true that as a result of downward revisions in incoming revenue estimates since the President's budget was released, the percentage of funds withheld in 2002 will be lower than originally estimated, provided the PTO is given all the funding recommended in the President's budget. Nevertheless, the mere reduction in 2002 withholding on a percentage basis does not avoid the fact that the PTO will be in difficult straits for years to come even if aggressive action is taken now.

IPO members are skeptical that the previously withheld money is actually just "withheld". It is generally believed that the money has been "diverted" to unrelated government programs or used for deficit reduction and is in fact gone. However, it can be demonstrated that the PTO needs the withheld money desperately in order to provide the services that companies and inventors must have. If the withheld funds are actually merely withheld, it is now time for those funds to be made available to the PTO on a schedule that would permit the PTO to spend the money effectively to form systemic solutions to the impending "crisis". Massive hiring alone is not the solution. Attention must be paid to retention, training and automation (e-government). Merely cutting back on the time examiners have to do their examination of applications just to improve pendency is also no solution. PTO examiners need the tools and the time to do the quality job that the public deserves.

SOLUTIONS TO THE FUNDING PROBLEM

The solution to the funding problem is thus to provide the PTO with the resources it needs to do its job, even if the PTO needs an amount greater than the fees that are being paid by PTO users. The time when an amount less than fee collections can even be considered is past. Rather, the discussion now should be on a program for retrieving past withheld fees to help solve the problems that past withholdings have helped create.

We recognize that the members of this Subcommittee have long fought for adequate funding for the PTO. We are encouraged that the officials of the incoming Administration who have been looking into the PTO's needs also are looking at what the office NEEDS. That is the only basis upon which a PTO recovery program can be fleshed out and implemented.

We readily endorse the new bill H.R.——, introduced this week by Chairman Coble and cosponsored by Mr. Berman and Mr. Conyers, which authorizes 2002 PTO funding, authorizes special funding for electronic filing and processing, and requires a 5- year PTO strategic plan.

H.R.——authorizes appropriations for the PTO in 2002 in an amount equal to the fees collected in fiscal year 2002 under the patent and trademark laws. Appropriations for 2002 in this amount would be a major step forward for the PTO

H.R.——authorizes \$50 million in each fiscal years 2002 and 2003 to develop an electronic system for the filing and processing of patent and trademark applications. The bill states that the system should:

- Be user friendly; and
- Include the necessary infrastructure -
 - a. to allow examiners and applicants to send all communications electronically; and
 - b. to allow the Office to process, search and maintain electronically the contents and history of each application.

IPO has long supported PTO adoption of information technology such as electronic filing. So far the PTO's patent electronic filing system has not progressed very far. By authorizing special funding for such an electronic system and specifying the objectives for it, the bill provides important Congressional approval and direction.

H.R.——also requires the PTO to develop a strategic plan that sets forth the goals and methods by which the PTO during a five year period will:

- Enhance patent and trademark qualities;
- Reduce patent and trademark pendency; and
- Develop and implement an effective electronic system for use by the Patent and Trademark Office and the public for all aspects of the patent and trademark processes, including. . .searching, examining, communicating, publishing, and making publicly available, patent and trademark registrations.

The PTO strategic plan is to include milestones and objectives and meaningful criteria for evaluating progress. The bill requires the PTO to develop the strategic plan in close consultation with the Patent Public Advisory Committee and the Trademark Public Advisory Committee, and to submit the plan to the House and Senate Judiciary Committees. This guidance on a PTO strategic plan delineates the most important goals and establishes a mechanism for tracking progress involving Congress and the private sector.

As an alternative to asking the Appropriations Committees each year to appropriate adequate funds for the PTO, Congress could enact Chairman Coble's bill H.R. 740 or Mr. Berman's resolution H. Res. 110 to eliminate or limit the authority of the Appropriations Committees to withhold PTO fees. We support these measures. The Commerce, Justice and State Appropriations Subcommittees have their problems in allocating scarce funds among competing programs, but they should not view PTO user fee money as "discretionary" in the same sense as taxpayer money appropriated from the government's general fund. User fees in the PTO account in the Treasury are funds that have been paid by American corporations and inventors for specific services that they expect to receive.

In our statement at last year's oversight hearing before this Subcommittee, we raised the question of whether diverted fees constitute a direct tax on personal property in violation of Article I, Section 9 of the Constitution, which prohibits a direct tax unless it is laid in proportion to the census. We have continued to look into constitutional issues. We now believe that a real diversion of fees also might be a prohibited taking of private property for public use under the 5th Amendment of the Constitution. These possible constitutional issues are based on the premise that Congress has taken patent and trademark fees. If fees have been taken, the constitutionality of fee diversion should be further investigated. If the fees have not been taken, as I have said, then there is an urgent need to use the \$871 million in "withheld" fees to address the critical problems facing the PTO.

Again thank you for the opportunity to speak to the Subcommittee. I will be pleased to answer any questions.

Attachment: May 22, 2001 letter sent to Congress by 61 companies and 18 associations

ATTACHMENT

21ST CENTURY INTELLECTUAL PROPERTY COALITION

1255 TWENTY-THIRD STREET NW, SUITE 200

WASHINGTON, DC 20037

May 22, 2001 Sent to U.S. Senators and Representatives

RE: Retention of User Fees by the Patent and Trademark Office Dear Senator/Representative: We are 61 companies and 18 associations in strong support of securing adequate funding for the U.S. Patent and Trademark Office (PTO). No other government agency is more important to the growth of innovation and commercial activity in our nation than the PTO. The ability of our nation's small and large businesses to promptly obtain valid patents and trademark registrations helps create new industries and high-wage jobs. This process is critical to our global competitiveness and technological leadership. The PTO is responsible for granting these important rights. The PTO is entirely supported with the fees paid by patent and trademark applicants—it receives no taxpayer funds. Since 1992, however, Congress has been withholding an increasing portion of these fees almost every year for use in other government agencies. Over the last four years Congress has withheld an average of \$100 million a year. This year the President's budget proposes to withhold \$207 million and the Administration plans to withhold an average of \$184 million per year through FY 2006. Fee withholding has substantially damaged the PTO's ability to examine and issue valid and enforceable patents and trademark examinations on a timely basis. The PTO's own estimates show that pendency of patent applications will rise from 25.0 months in FY 2000 to 38.6 months in FY 2006—a 54% increase! The processing of trademark registrations will be adversely affected as well. Without the necessary funding, the PTO cannot (1) maintain—much less enhance—the quality of issued patents and the caliber of the trademark examination process; (2) improve its services using additional automation efforts; or (3) reduce overall patent and trademark processing time.

If the PTO cannot function efficiently, the development of new technologies will suffer and businesses will stagnate. With that in mind, we hope you will support the necessary resources that the PTO so desperately needs. For more information, please contact Wayne Paugh at (202) 521-6717.

Sincerely,

Member Companies

3Com Corporation

3M

Accenture

Agilent Technologies

Air Products and Chemicals, Inc.

Alcatel

Amazon.com

Anatomic Research, Inc.

Apple Computer

AT&T Corp.

Avaya Inc.

Aventis Pharmaceuticals, Inc.

BASF Corporation

The B.F. Goodrich Company

BP America Inc.

Caterpillar Inc.

Celanese

Compaq

Corning Incorporated

Deere & Company

The Dow Chemical Company

EDS Corporation

Eastman Chemical Company

Eastman Kodak Company

Eli Lilly and Company

EMC Corporation

Emigre Inc.

Encyclopaedia Britannica, Inc.

Ford Global Technologies

General Electric Co.

GlaxoSmithKline

Henkel Corporation
 Hewlett-Packard Co.
 Honeywell
 Illinois Tool Works Inc.
 Immunex Corp.
 Intel Corporation
 International Business Machines Corporation
 J.P. Morgan Chase & Co.
 Johnson & Johnson
 Monsanto Company
 Motorola, Inc.
 Oracle Corp.
 Panasonic / Matsushita Electric Corp. of America
 Parker Hannifin Corporation
 Pfizer Inc.
 Pitney Bowes Inc.
 PolyOne Corporation
 PPG Industries, Inc.
 Procter & Gamble Co.
 Reed Elsevier Inc.
 Research Triangle Institute
 Rockwell International Corporation
 Rohm and Haas Company
 SilverPlatter Information, Inc.
 StorageTek
 Tektronix, Inc.
 Unisys Corporation
 United Technologies Corporation
 W.L. Gore & Associates, Inc.
 Xerox Corp.
 Xilinx, Inc.

Member Associations

Aerospace Industries Association (AIA)
 American Chemistry Council
 American Electronics Association (AeA)
 American Intellectual Property Law Association (AIPLA)
 Association for Manufacturing Technology
 Biotechnology Industry Organization (BIO)
 Business Software Alliance (BSA)
 Computing Technology Industry Association (CompTIA)
 Electronic Industries Alliance
 The Financial Services Roundtable
 Information Technology Industry Council (ITI)
 Intellectual Property Owners Association (IPO)
 International Intellectual Property Institute (IIPi)
 International Trademark Association (INTA)
 National Association of Manufacturers (NAM)
 Pharmaceutical Research and Manufacturers of America (PhRMA)
 Semiconductor Industry Association (SIA)
 Software & Information Industry Association (SIIA)

Mr. COBLE. Thank you Mr. Myrick.
 Mr. Montan.

STATEMENT OF NILS VICTOR MONTAN, VICE PRESIDENT, SENIOR INTELLECTUAL PROPERTY COUNSEL, WARNER BROTHERS ON BEHALF OF INTERNATIONAL TRADEMARK ASSOCIATION (INTA)

Mr. MONTAN. Thank you. Good afternoon, Mr. Chairman. On behalf of the 4,000-plus members of the International Trademark Association I want to thank you and the Subcommittee for the opportunity to assist you in the oversight of the USPTO.

Mr. Chairman, you recognized the important role the PTO plays in projecting intellectual property when you ushered through Con-

gress the American Inventors Protection Act, important legislation designed to allow the PTO to be run more like a private sector business, able to keep pace with customer demand without the problems of government red tape. This makes sense since all of PTO's funds come from fees, not from taxpayer dollars. The goals of that landmark legislation are being undermined, however, when money derived from PTO fees are continually diverted to other government agencies and programs.

For fiscal year 2002, although the actual amount is under some speculation, it is obviously hundreds of millions of dollars. This annual diversion of PTO dollars is essentially, as Mr. Berman said, an innovation tax on IP owners and a drain on the agency. It is an innovation tax that should be stopped.

Now, there are those that will say that this kind of tax is okay since the PTO will have enough money to get by. Yet the PTO should have the tools to do more than just get by. After all, this is the agency that stands at the forefront of an economy driven by technology, innovation and information. The PTO must have the resources it needs to support the entrepreneurs and innovators of this Nation.

After all, private sector business does not have the money taken away from it when there is still work that needs to be done. Nor should money be taken away from the PTO when it is trying to grapple with a record setting backlog of pending trademark applications.

The PTO is developing exciting new technologies to move the agency away from manual intensive processes that have long burdened the system. These are the initiatives that will enable the PTO to do more than just get by, but these are the initiatives that will be stifled if rampant fee diversion is not halted.

Mr. Chairman, you and Ranking Member Mr. Berman have led the fight to keep the PTO funds at the PTO. We know that fight has not been easy, but we urge you to stay the course and continue to work this issue. The INTA pledges its support and its resources in this regard.

Unfortunately Mr. Chairman, in addition to the withholding of fees, the PTO also continues to be hampered by governmental processes that the AIPA was supposed to reduce. For example, the PTO is subject to a recent agencywide Department of Commerce hiring freeze despite an unprecedented backlog of unregistered trademark applications, which now stands at over 547,000.

Thankfully that hiring freeze has now been lifted, but our point is that it never should have been imposed on the PTO in the first place. The statute is clear, the Commerce Department has jurisdiction over policy, but not over matters concerning personnel. If the PTO needs the personnel and can pay for them, the PTO should be able to get them. We ask for your support in making sure that the PTO is no longer subject to Commerce Department hiring freezes.

Now, as a result of the continuing diversion of fees and the hiring freeze, the PTO is being forced to do more with less. I think the agency deserves great praise for coming up with ideas that address this unwelcome reality. For example, as Mr. Godici mentioned, there is the expansion of the work-at-home program, pro-

viding examiners with more flexible hours. The PTO has also designed an innovative bonus system for examiners, which is reportedly working very well in increasing productivity.

Electronic filing is another way to help improve the examination process. The INTA supports greater use of the PTO's e-filing system. The benefits of this system are clear: Use of the e-filing system means less paper and less of a chance, therefore, that paper will be lost or misplaced, which is still, unfortunately, a common problem at the PTO.

We believe that more resources need to be provided to the agency to accomplish this task of finding electronic means to streamline the PTO process.

Before I wrap up, Mr. Chairman, I want to reiterate INTA's great desire to see the Madrid Protocol passed during the 107th Congress. The implementing legislation has already passed the House, thanks to you. We must now encourage the Senate to take action. U.S. trademark owners should be able to join their counterparts in other major industrialized countries in enjoying the benefits of the Madrid system, especially the savings in time and money. The time has come for the United States to join this system.

Mr. Chairman, this concludes my statement. Again I want to thank you, Mr. Berman, and the Subcommittee for inviting the INTA here today. We look forward to being a partner in making the PTO a better and more efficient customer service agency.

[The prepared statement of Mr. Montan follows:]

PREPARED STATEMENT OF NILS VICTOR MONTAN

INTRODUCTION

Good afternoon, Mr. Chairman. My name is Nils Victor Montan, and I currently serve as President of the International Trademark Association ("INTA"). I am employed by INTA member Warner Bros. as Vice President and Senior Intellectual Property Counsel. As with all INTA officers, board members, and committee members, I serve on a voluntary basis.

INTA is pleased to be here today to participate in this hearing of the Subcommittee on Courts, the Internet and Intellectual Property in connection with its oversight of the United States Patent and Trademark Office ("PTO"). In many ways, my comments serve as a follow-up to those offered to this subcommittee by my predecessor as President of INTA, Kim Muller, when he testified before you at the last PTO oversight hearing on March 9, 2000.¹ They address such topics as the diversion of PTO funds and the implementation of operational reforms put in place by the *American Inventors Protection Act* ("AIPA").² Additionally, I want to comment on programs at the PTO that are designed to do more work with fewer resources, on quality of examination, electronic filing, and the progress of the Madrid Protocol.

INTA is a 123-year-old not-for-profit organization comprised of over 4,000 member companies and firms. It is the largest organization in the world dedicated solely to the interests of trademark owners. The membership of INTA, which crosses all industry lines and includes both manufacturers and retailers, values the essential role that trademarks play in promoting effective commerce, protecting the interests of consumers, and encouraging free and fair competition. The members of INTA, who routinely apply for and maintain trademark registrations, are the customers of the PTO. INTA therefore has a strong interest in the agency's performance and in working with the Congress, PTO officials, and others to ensure that the PTO can operate efficiently and in an effective, business-like manner.

¹ Testimony of Kimbley L. Muller, President, International Trademark Association, United States House of Representatives, Committee on the Judiciary, Subcommittee on Courts and Intellectual Property, "Oversight Hearing on the United States Patent and Trademark Office," March 9, 2000.

² Public Law 106-113 (1999).

PERSONNEL, THE BACKLOG, AND FUNDING

At the March 2000 oversight hearing, emphasis was placed on the implementation of the *AIPA*, which reflected the approach of this subcommittee and the Senate Judiciary Committee in creating a more effective government agency.

A major part of the *AIPA* were provisions designed to allow the PTO to be run more like a private sector business, able to keep pace with customer demand through independent control of budget allocations and expenditures, personnel decisions and processes, and procurement.³ This means that government red tape, which had significantly affected PTO efficiency and operations in the past, was to be reduced to the bare minimum.

Personnel

Unfortunately, Mr. Chairman, the PTO continues to be hampered by governmental processes that the *AIPA* and this subcommittee's efforts tried to reduce. For example, the PTO was subject to a recent agency-wide Department of Commerce (DOC) hiring freeze despite a record-setting backlog of pending, unregistered trademark applications, which, as of April 2001 stood at 547,101. This figure represents an increase from previous years. In September 2000, the backlog number was 520,053. In September 1999, it was 444,616.

The letter and spirit of your legislation gave the leadership of the PTO the authority to hire additional personnel on an as-needed basis.⁴ Although the hiring freeze has, for the most part, been lifted, we believe that subjecting the PTO to a hiring freeze at all was inconsistent with your intent and the language in the *AIPA*. Nor was it justified in light of the backlog of trademark applications, and the fact that pendency for trademarks is still above the benchmark 3/13 levels.⁵ We hope that no new hiring freeze will be imposed on the PTO in the future and ask for your support in this matter.

Funding

We believe that the oversight goals of your subcommittee are also undermined when money derived from PTO fees and intended for the examination or maintenance of intellectual property is diverted to other government agencies and programs. I am referring, of course, to the now annual diversion of PTO money due to "scoring" and limited appropriations allocations. For FY 2002, the proposed figure is \$207 million.⁶ Last fiscal year, the number was \$113 million.⁷ The administration plans to withhold an average of \$184 million per year through FY 2006. When will this tax on the customers of the PTO end?

A private sector business does not have money taken away when there is still work that needs to be done, when, as is the case with the PTO, there is a backlog of unexamined trademark applications. Nor should money be taken away when the PTO is trying to keep pace with the annual increase in applications through new technology. INTA has been told that further development of TICRS, a scanning system designed to help keep better track of all documents submitted to the agency that relate to applications and registrations, may be delayed if funds continue to be diverted. With TICRS, instead of the labor-intensive, manual process of trying to track the physical location of hundreds of thousands of documents, an examiner will have instant, electronic access to all documents relating to a particular application or registration. Not only does this reduce manpower needs, it helps alleviate the all too common problem of "lost" files and the subsequent delays this causes. A delay in funding initiatives such as TICRS ultimately costs more than just time. A start-and-stop approach to systems development is highly inefficient, as people familiar

³H. Rep. No. 464, 106th Cong., 1st Sess. 113 (1999).

⁴"In carrying out its functions, the United States Patent and Trademark Office shall be subject to the policy direction of the Secretary of Commerce, but otherwise shall retain responsibility for decisions regarding the management and administration of its operations and shall exercise independent control of its budget allocations and expenditures, personnel decisions and processes, procurements, and other administrative and management functions in accordance with this title and applicable provisions of law," Section 4711 of S. 1948, the *Intellectual Property and Omnibus Communications Reform Act of 1999* (incorporating the *AIPA*), 106th Congress. Note: S. 1948 was eventually placed into H.R. 3194, the *Consolidated Appropriations Act for FY 2000*, Public Law 106-113.

⁵By March 30, 2001, average first action pendency was 5.6 months. For final disposition, the average was 17.4 months (U.S. Patent and Trademark Office, *Mid-Year Update: Trademark Operations*, April 30, 2001). The accepted benchmarks are 3 months for first action and 13 months for final disposition.

⁶See FY 2002 *Budget in Brief*, Page 106. The president's proposed budget calls for a PTO spending cap of \$1,139 million. However, the agency is expected to take in \$1,346 million in fee-generated revenue during the fiscal year.

⁷*Federal Register*, Consolidated Appropriations Act for FY 2001, December 15, 2000, Page H12404.

with the project are pulled off their work and assigned to other tasks. When funding is restored, new people become involved, and this disconnect increases costs and affects the quality of the technology being developed.

Mr. Chairman, I know that you, along with the Ranking Member, Mr. Berman, as well as the leaders of the full Judiciary Committee, Mr. Sensenbrenner and Mr. Conyers, are as disturbed by the habitual diversion of PTO money as are the customers of the agency who are the ones footing the bill. You have acted above and beyond the call of duty when it comes to finding a solution to the problem. INTA thanks you for your endeavors and hopes that you will continue to work with us to find a way to ensure that all the money raised through PTO fees stays with the agency.

You will no doubt be advised during the course of this hearing and in days and weeks to come that the proposed FY 2002 budget for the PTO will allow the agency to essentially "get by," "to do its job," that the money that has been assigned to the PTO by the president is "okay," and that there is no cause for alarm. I respectfully state, however, that the PTO should have the tools to do more than "just get by"—to do better than just marginally keep its head above water. The trademark community's impression is that this was the intent of the AIPA. Our collective goal should be to take that intent and make it a reality. Let me also make the obvious point that there should be no fee increases at the PTO until this diversion problem is solved once and for all.⁸ That would add financial insult to financial injury.

DOING MORE WITH LESS

The PTO is being forced to do more with less, and the agency deserves praise for coming up with ideas that reflect that unwelcome reality. For example, there is expansion of the work-at-home program. Ninety-one trademark examining attorneys now work at home, providing the examiners with more flexible hours. Practitioners working on the west coast are apt to receive phone calls at 4:00 pm Pacific time from a work-at-home examiner who is taking care of business at 7:00 pm Eastern time. This is indeed a step in the right direction.

The PTO has also designed a bonus system for examiners, which is reportedly working very well in increasing productivity, as measured by the number of applications examined. Examiners can work overtime and earn up to \$10,000 per year in bonuses. There are also supplemental bonuses for mentoring new examiners and for maintaining quality of examination at an outstanding level. PTO estimates that the new bonus system will result in a 10% increase in production, which is the equivalent of having 41 additional examiners.

We have had some concerns that in the rush to examine more applications and earn the bonus, examiners may relax their quality standards. Senior PTO personnel have reassured us that for an examiner to receive a bonus, he or she must maintain a "fully successful" quality rating and that the supplemental bonus for quality is intended to help keep examination quality at a high level. The agency has indicated that it is closely monitoring the connection between quality and the bonus program.

QUALITY OF EXAMINATION QUALITY OF EXAMINATION

The quality of substantive examination of applications for registration of trademarks remains a significant issue for the trademark community. Recently, members of the trademark bar have reported concern with the appropriateness of PTO actions refusing registration of trademarks based upon determinations by PTO examining attorneys that the trademark will either be confused with a prior trademark or one that has already been registered with the PTO, a basis for a refusal of registration under §2(d) of the *Trademark Act of 1946*, or that the mark is "merely descriptive or deceptively misdescriptive" of the goods to which it is being applied, a basis for refusal under §2(e)(1). The 2000 PTO customer satisfaction report, to our knowledge the most recent one that has been published, confirms that less than half of the respondents to the agency's customer satisfaction survey were satisfied with refusals to register made under 2(d) and 2(e)(1).⁹

INTA's PTO Subcommittee has been working with senior PTO officials, including those at the agency who manage trademark law offices, to try and improve examining attorney performance in the area of 2(d) and 2(e)(1) refusals. We believe that

⁸On May 24, 2001, INTA sent a letter to the PTO in opposition to a proposed increase in the trademark application fee, per class. The proposed increase is based on the Consumer Price Index and would raise the fee from \$325 to \$340.

⁹United States Patent and Trademark Office, *2000 Customer Satisfaction Report*, Page 14 [45% of the respondents were satisfied with refusals made under 2(d) and 41% were satisfied with refusals made under 2(e)].

inappropriate refusals are related, to a certain degree, to a lack of experience on the part of examining attorneys. Coupled with the lack of attorney experience was a very substantial increase in new trademark filings, which required the PTO to move new cases forward more rapidly. We believe unseasoned employees and emphasis upon quick examination, at least in the first instance, has taken its toll on the quality of examining attorney work product. To remedy this situation, we have made a number of recommendations, including the following:

1. Placing greater emphasis on consistency (i.e. establishing guidelines for evidentiary support for examiner action based on 2(d) and 2(e)(1) refusals).
2. Management/senior review of final refusals under 2(e)(1).
3. A formal refresher course on 2(d) and 2(e)(1).
4. Gathering and maintenance of data on substantive refusal issues that are then withdrawn.
5. Encouraging examiner consultation with a manager or senior lawyer in response to applicant request for reconsideration of position.

We hope that the PTO will adopt some or all of these recommendations.

ELECTRONIC FILING

INTA does indeed support greater use of the PTO's e-filing system. The benefits are clear. Among them, an applicant for a trademark registration receives his or her filing receipt within 24 hours. The filing receipt is also free from mistakes by clerical personnel at the PTO, since no additional data entry is required. The filing receipt is identical to the data submitted by the applicant (or his attorney). Additionally, use of the e-filing system means less paper and less of a chance therefore that the paper will be lost or misplaced, which is still a common problem at the PTO.

The use of e-filing is increasing. In FY 2000, 44,108 or 14.9% of the trademark applications were filed electronically.¹⁰ Figures for FY 2001 look promising. In the first quarter alone, 12,800 or 21% of the applications were filed electronically.¹¹ The PTO's goal is to reach 30% by the end of this fiscal year.¹² I believe that trademark owners and their counsel are becoming more familiar with the system and its benefits. The leadership of the PTO, especially Commissioner for Trademarks Anne Chasser and Deputy Commissioner for Trademarks Bob Anderson, must be complimented, not only for their efforts in educating the trademark bar, but for their responsiveness in addressing their customers' concerns regarding the electronic filing system and its capabilities.

Additionally, we understand that the PTO continues to fine tune the system and upgrade its capabilities in response to comments made by the trademark bar.

While INTA supports greater use of the PTO's trademark e-filing system (commonly known as "TEAS"), we are not prepared at this stage to endorse a proposal to make e-filing mandatory. Earlier this year, there was speculation that the agency was planning to propose a rule change that would create a mandatory e-filing system. Among the reasons offered in support of such a rule were: (1) reduction paper in light of the increasing number of trademark applications; (2) reduction in space requirements; (3) lower pendency rate; (4) cost reductions; and (5) preparation for the implementation of the Madrid Protocol.

As of this date, the proposed rule has not been published for public comment in the *Federal Register*. I think this was a wise choice by the agency, since there would likely have been strong opposition. Perhaps the projected slowdown in the increase in trademark applications,¹³ increased voluntary use of the e-filing system, and delays in passing the Madrid Protocol were also contributing factors to the decision by the PTO not to press mandatory e-filing at present.

INTA could not agree more with the PTO's reasons for wanting to see e-filing put to greater use by trademark practitioners. As I noted earlier, the benefits are obvious. In some quarters of the trademark bar, however, there are still concerns about the reliability of the PTO computer systems, especially with regard to transmission of specimens and stylized marks in electronic format. Moreover, there is concern that the systems will not be able to handle the volume of e-filing applications under

¹⁰United States Patent and Trademark Office, *Briefing Book for Trademark Public Advisory Committee*, March 1, 2001, Page 31.

¹¹USPTO, *Briefing Book*, Page 31.

¹²USPTO, *Briefing Book*, Page 31.

¹³In the president's proposed FY 2002 budget, there was a projection of 450,000 trademark applications during the fiscal year. The PTO has revised that number and now predicts that it will receive approximately 360,000 trademark applications during FY 2002 (United States Patent and Trademark Office, *Fiscal Year 2002 Budget Request*).

mandatory electronic filing. INTA's PTO Subcommittee has raised these and other issues with PTO personnel, and my understanding from reviewing the agency's responses to these concerns is that upgrades have been made to the system and that it is routinely monitored for performance and capacity. I urge the PTO to make better known to the trademark bar the enhancements that have been made to the e-filing system and the steps that the agency is taking to ensure its reliability. Certainly, INTA will assist the PTO in this communications effort.

There are also lingering issues about signatures on an e-filing document. The reports that I have received from some trademark practitioners concern logistical difficulties in getting a client's signature using the e-system.¹⁴ First, a practitioner has to go on to the PTO website, fill out the e-form, download it, send it to the client to sign, and then get it back onto the PTO site for transmission. For some practitioners, it is simply easier to do things the "old-fashioned" way by filling out the form, faxing it over to the client for a signature, and then sending it to the PTO via regular or express mail.

We do know that the PTO is looking at ways to simplify the process for obtaining a signature on e-documents. There are two prototypes in development:

1. Under the first prototype, the applicant will be able to access the application form directly from a hyperlink included in an e-mail generated upon completion of the form by the trademark practitioner.
2. The second prototype allows the trademark practitioner to complete the e-application, print out a hard copy and forward it to the applicant for a traditional pen-and-ink signature. The practitioner can then scan the application once it is returned and affix it to the original e-version of the application. The complete trademark application may then be validated and filed electronically.

INTA is hopeful that these new innovations will be successful, thereby increasing the use of the e-filing system.

If in fact the new signature innovations are not successful in eliminating difficulties in electronic filing, the INTA PTO Subcommittee is prepared to examine whether changes to document signature requirements should be considered, including exploring the possibility of eliminating signature requirements.¹⁵ I want to stress that our subcommittee has not made any recommendation to the INTA Board of Directors concerning signatures. We do not know whether this change is a good idea. The INTA PTO Subcommittee plans to canvass the association's membership during the summer and fall to see if elimination of the signature requirement is possible under the present statutory and regulatory scheme, and what effect, if any, elimination of signatures on documents might have on trademark owners. Of course, if INTA determines a recommendation to eliminate signatures is appropriate, that change may require legislative action, and INTA will work with this subcommittee in that regard.

MADRID PROTOCOL

Before concluding my statement, Mr. Chairman, I want to reiterate INTA's desire to see the Madrid Protocol passed during the 107th Congress. We know that you have successfully passed the implementing legislation here in the House¹⁶ and have been encouraging the Senate to follow suit, as well as pass an "advice and consent" resolution.¹⁷ At present, the Senate implementing legislation is awaiting consideration by the Senate Judiciary Committee and the "advice and consent" resolution by the Foreign Relations Committee.

INTA thanks you for your efforts, Mr. Chairman, in striving to secure U.S. adherence to the Madrid Protocol and ask that you continue along the same path. There is no reason why the U.S. should not join other major industrialized countries such as France, Germany, Italy, Japan, and the United Kingdom in enjoying the benefits of the Madrid Protocol. The Protocol saves time and money and will permit United States trademark owners to go to market with their goods and services more quickly in the 51 countries that are currently members of the Protocol. It should be made available here in the United States as soon as possible.

¹⁴Technically, as a result of the passage of the Trademark Law Treaty, a signature is not needed on the application in order to get a filing date. However, it is necessary during the examination stage. In order to file a completed application, some practitioners do obtain the signature at the time of filing.

¹⁵At present, the U.S. is one of the few countries that still require a signature.

¹⁶H.R. 741.

¹⁷S. 407.

CONCLUSION

Thank you again, Mr. Chairman, for the opportunity to assist in the subcommittee's oversight of the PTO. The PTO plays a critical role in promoting, safeguarding, and maintaining America's ingenuity and creativity so that the nation can continue to enjoy a robust economy and be a leader in the global marketplace. INTA looks forward to working with this subcommittee to ensure that the PTO has the necessary resources and flexibility to do its job.

Mr. COBLE. Thank you, Mr. Montan.
Mr. Stern.

**STATEMENT OF RONALD J. STERN, PRESIDENT, PATENT
OFFICE PROFESSIONAL ASSOCIATION (POPA)**

Mr. STERN. Thank you, Mr. Coble. We really appreciate the opportunity to present our views today, and we very much appreciate your support and Mr. Berman's support for retaining our fees. I think we are really counting on you to come through on that.

But aside from the fees, the biggest challenge that the USPTO faces right now is that it needs more examiners, and it needs them for two reasons: First, there has been a huge increase in workload and, second, to increase the quality of patents examiners need more time per case. Based on an average examination time of roughly 20 hours, the agency is short approximately 1,000 examiners compared to the number needed to handle the 330,000 patent applications that are expected to be filed this year.

There is a critical need for improvement for the quality of our searches and for time to handle the increased complexity of applications. The time factors we currently work under were last revised in 1976. Since that date the average patent application has grown more complex, searches have grown longer, and the number of claims per application has increased. In spite of this relentless inflation and the need for more time, the agency continues to pressure employees to use less time. As an inexpensive way of increasing available examining time, we recommend encouraging overtime by increasing through legislative action the overtime pay rate to a level equal to the straight time pay rate.

In addition to that, we need more reclassification efforts independent of whether we automate our search system or maintain our paper files. Filing patent and nonpatent literature, especially the literature submitted by applicants, need to be classified into the U.S. classification system and added to our files.

We wish to state this unequivocally; more computers will not solve our problems. There simply aren't any computers that can read about inventions, understand them and make meaningful comparisons with prior interventions to determine novelty and the obviousness of any differences. No matter how much money is spent on automation, the only way to increase the output of the agency is to hire more examiners.

Funding for automation must come after funding for adequate staff. Currently the aggregate salary of all the examiners and classifiers that my organization represents in the technology centers is about \$220 million, including the most recent pay raise. On the other hand, the budget of the Chief Information Officer is \$239 million in the current year. The trade-offs between staffing levels and particular automation projects need to be made public so that there

can be an informed discussion of what is most valuable to the country.

We strongly support H.R. 740 and House Resolution 110 so as to ensure that applicants' fees are used for their intended purpose, and we do believe that both of those bills can be enacted together and are compatible with each other.

However, H.R. 2047 we believe needs some improvement. Funds should be authorized for automation only after a detailed cost-benefit analysis has been made available for public debate and the Subcommittee decides that the convenience of computerization outweighs the cost of increased pendency.

I would like to report that there is very good news for labor relations. POPA would like to thank the senior management at the PTO, including Acting Commissioner Nick Godici and the other senior members there, for implementing programs which enhance employee satisfaction. Flexibility in choosing work hours and pay increases will go a long way to enhance recruitment of employees and induce current employees to stay with the agency despite attractive salary packages that have been offered by the private sector.

Thanks also go to you, Mr. Chairman and the other Members of the Subcommittee, for placing employee organizations on the Public Advisory Committee of the Patent and Trademark Office. We thank you for giving us this opportunity to present our views.

[The statement of Mr. Stern follows:]

PREPARED STATEMENT OF RONALD J. STERN

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to provide the views of the Patent Office

Professional Association. Our organization is the exclusive bargaining agent for the approximately 3300 patent professionals at the U.S. Patent and Trademark Office. The vast majority of the employees we represent are engineers, scientists, and lawyers who work as patent examiners and patent classifiers.

There are three bargaining units at the USPTO. POPA represents more than one and a half times the number of employees represented by the other two bargaining units put together. The percentage of organized employees that we represent in the USPTO is continuously growing.

As everyone is aware, patents play a vital role in our high technology economy. They serve as a incentive for companies to innovate, and as an engine for efficiency in all spheres of economic activity. While many people would like to "work smarter, not harder" to achieve their goals, patents provide the know-how to enable people to actually "work smarter". Patents are the intellectual gemstones of commerce, recognized by our founding fathers.

The biggest challenge that the USPTO faces right now is that it needs more examiners. It needs them for two reasons. First, there has been a huge increase in workload. Second, more time needs to be allocated per case so that we can do a better quality job, and especially provide a better search of the prior art. We believe that the USPTO needs to put the hiring of examiners at the top of its list of priorities and leave it there for about five years.

THE WORKLOAD

To understand the dramatic increase in the USPTO's workload, consider that in this year FY 2001 the agency expects approximately 330,000 applications to be filed, a 21% increase over the 278,268 filed in Fiscal Year 1999. The average amount of time allocated for examination of an application is roughly 20 hours. If the 330,000 applications the agency expects to have filed this year are multiplied by 20, you will get the total number of hours necessary for examination. If you then divide the total by the number of hours the average examiner spends examining per year, usually 1664 hours, you can see that the agency will need about 4000 examiners just to han-

dle this year's filings. Since it has only about 3000 examiners, that means that the agency is short by approximately 1000 examiners, if it just wants to stay current.

Of course, the agency also has a backlog. At the end of FY 2000, there were approximately 408,000 patent applications either awaiting action or in the process of being examined. We cringe at the thought of the FY 2001 backlog. All this means is that we are behind on our workload, and losing ground. We are losing ground fast.

We wish to state this unequivocally: more computers will not solve these problems. There simply aren't any computers on this planet that can read about inventions, understand them, and make meaningful comparisons with prior inventions to determine novelty and the obviousness of any differences. You need a person to actually read these 330,000 patent applications page by page, to research the prior inventions, to determine whether the invention is clearly expressed in the claims and has utility, and whether the invention is novel and non-obvious. Computers cannot do this.

What this means is that no matter how much money is spent on automation, the *only* way in which the throughput of the agency can be increased is by hiring more examiners.

This is an important point with respect to Congressional oversight. Last year Fiscal Year 2000, when record numbers of applications were being filed, the agency allowed examiner staffing levels to actually decline by about 2%.¹ This decline was due to the fact that the budget for the USPTO passed by the House Appropriations Committee was so small that the agency stopped hiring because it was afraid that it might otherwise run short of money. The agency didn't receive its FY 2001 budget until December, so it wasn't clear for many months how much money the agency would have to spend on new hires. Since then, the agency has been faced with a short, temporary hiring freeze as part of the transition to a new administration. Thus, even though the FY 2001 appropriation is approximately 17.5% higher than the funds available for obligation in FY 2000, hiring has so far only covered losses due to attrition.

Such disruptions in hiring are almost impossible to overcome because there is a limit on how many employees can be hired and trained in any one year. Hiring close to that limit would be necessary every year to just meet workload increases. Consequently, losing almost an entire year is serious. The agency will be feeling the effects of the disruption in hiring for years to come. If Congress provides for the agency to keep all of its fees and does not subject it to the vagaries of the appropriation process, then the agency will be able to maintain a uniform hiring pattern that will allow for proper training and an adequate increase in staff.

MORE TIME FOR IMPROVING QUALITY

As I have testified in years past, there is a critical need for improvement in the quality of our searches and for more time to handle the increased complexity of applications. The agency's Quality Review statistics continue to show a need for improvement in our ability to find the relevant prior art. More and more reporters and writers are criticizing the agency for issuing overbroad or otherwise potentially invalid patents. One Internet news provider continues to make a business out of criticizing the quality of the USPTO's work products, primarily because he believes that the most relevant prior art is not identified during examination. In addition, USPTO examiners report much more frequently than in years past that European searches identify references that are relevant but not found in our own searches.

USPTO examiners, who get about half the time allocated per application compared to EPO examiners, are convinced that there is a dire need to spend more time per application. Individuals outside the agency are also beginning to recognize the connection between the time we spend on an application and the quality of examination. As stated in a letter to the Editor of The Wall Street Journal published on March 21 of this year, "the probable cause of this situation [the issuance of invalid patents] is that patent examiners are not given enough time or resources to conduct adequate searches of the existing technology."

The time factors we currently work under were last revised in 1976. Since that date, patent applications have become significantly more complex on average, searches have become significantly longer and more time consuming, and the number of claims per application has increased. In spite of this relentless inflation in the need for more time, the agency continues to pressure employees to work faster. Quotas, which have not changed for years in spite of this growing complexity, are

¹In FY 2000 there was a net loss of 62 examiners. United States Patent and Trademark Office, Performance and Accountability Report, Fiscal Year 2000, page 27.

such that examiners frequently volunteer time to meet them. Supervisors still analogize the work we do to an assembly line for producing good middle of the road products and admit that they do not expect top of the line work in the time allotted per case. As some have said in the past, we produce Chevys, not Cadillacs.

The agency recognizes that when there is a need for a better search, it has to give more time. An example is what has been done in the business methods area. The agency became acutely aware of serious problems in this area through scathing articles in the press about alleged poor quality patents. This area is not distinguished on the basis of technological complexity, since it is no more complex than many other areas. What is different compared to other areas is that business methods do not have a classified set of patents that comprehensively set forth all the prior advancements in the field. As a consequence, searching must be done in the non-patent literature mostly found in databases located outside the agency. This process is extremely time consuming. Because the agency has recognized this, it provides on the order of at least 50% more time per case.

The expanded search program in the business methods area has been successful and has dramatically lowered allowance rates due to the additional time provided. While some have credited the lower allowance rates to a "second pair of eyes" procedure, we understand the additional review has only changed decisions in about 6% of the cases. We do not consider this aspect of the program to be cost effective.

Just as it is necessary in the business methods area to spend significantly more time to increase the scope of the search beyond classified documents, it will also take more time in other areas to increase searching beyond the classified art.

In order for us to maintain pendency levels and increase quality, it is essential that the agency hire more examiners. To hire more examiners, it needs to keep its fees. The need for more examiners will not be solved with automation or with contracting out. There is no automation technique on the horizon that will save examination time. The automation that has been provided until now, requires extra time, if anything, to search the additional sources of prior art technology to which it provides access. European patent examiners, who have approximately twice the time to search as examiners in the United States, use automation extensively for searching. To the best of our knowledge, their searching has not gone faster because of it.

As an aside, we can report that the European examiners have the same problems as the examiners in this country and are currently on strike for more pay and for maintaining the time in which to do their search and examination.

PTO management recognizes that our quality needs improvement, but, due to funding diversions, has prioritized computerization and other projects over increasing the time allocated to examination. As a consequence, USPTO management has committed to us that they would join us in trying to get funding for more examination time per case so as to increase the quality of issued patents.

OVERTIME AS A SUBSTITUTE FOR ADDITIONAL HIRES

A cost effective alternative to new hires is the encouragement of overtime. As we have suggested in past years, overtime can be encouraged by changing the existing statutory pay caps.

By statute the maximum hourly overtime pay is time and a half of grade 10, step 1. What this means is that our senior people, who produce at a rate approximately twice that of the junior people, get paid only about 60% of their regular pay when they are working overtime. Most folks are just not willing to work for a mere 60% of their normal pay.

Another statute limits total pay including overtime for a biweek to the amount payable to a GS-15, step 10 employee with no overtime. This cap denies, or limits, our most experienced primary examiners the opportunity to work paid overtime. Since these people are the most productive examiners in the agency, providing them an incentive to put in extra time will have a valuable payoff.

We recommend that you provide a legislative fix for the USPTO. H.R. 1770, which was introduced in the 106th Congress, and had the blessing of the Office of Personnel Management, had the right technical language to accomplish this. H.R. 1770 would not only have increased the hourly cap, but also would have increased the biweekly cap. The increases are limited to amounts that are already available to a few other Federal employees such as air traffic controllers and law enforcement officials. Although the bill did not pass, we think it should be implemented NOW for the USPTO because we are a production oriented organization in which overtime is directly linked to the examination of extra applications.

Lifting overtime caps is a win-win situation for both patent applicants—they get experienced examiners at a bargain rate—and for employees. Even though exam-

iners will be paid at straight time rates, the agency will save money because there will be no payments for additional employee benefits (retirement, health care and life insurance), no recruitment expenses, no payments for additional office space, no payments for additional computer workstations, etc.

OTHER NEEDED QUALITY IMPROVEMENTS

In addition, the agency needs to keep improving its search systems and this also requires an investment. The agency desperately needs to increase the amount of reclassification in the U.S. classification system, needs foreign art to be classified into the U.S. system and needs to expand its classified non-patent literature collections. Throughout much of the '90s, the agency took the position that automation would entirely eliminate the need for reclassification. As a result, the agency has not budgeted for reclassification and has permitted the size of the classes and subclasses to grow. Now that we have areas where the subclasses are too large to properly search, we have found the agency's position that reclassification is unnecessary in the electronic age to be far from the truth. Properly classified classes and subclasses are critical to doing a quality job in an automated search environment.

Without reclassification, subclasses have grown to include thousands of documents, making it difficult or impossible to do a classified search, either in paper or electronically, in the time allotted. To save search time, examiners are forced to rely more heavily on text or key word searching. Text searching, i.e., searching the patents using the key words or phrases, is risky because concepts can be described many different ways using many different sets of words. The examiner will try to use terms that encompass all or most possible ways of representing a concept, but when doing so, will frequently end up with a result set that is either so large that it can't be reviewed in the time allotted, or one that is so small, that many of the relevant documents have been missed completely. The ability to combine a search for certain terms with the subclasses where the concept being searched should be classified permits the examiner to avoid using overly limiting search terms and aides the examiner by eliminating many irrelevant documents. We need to fund reclassification of the U.S. classification system.

For three years in a row, we have reported the need to reclassify foreign art into the U.S. system so that the foreign documents may be located through a classified search. There is still no system in place to do this. The agency still says that it is in the process of developing a system to do this.

One idea that has been discussed in the Patents Public Advisory Committee (P-PAC), which we strongly support and recommend be adopted, is to allow examiners to classify documents they receive from applicants as parts of Invention Disclosure Statements into the U.S. system for inclusion in our search files. What is relevant for one application is, more likely than not, also relevant to others. This is a good source of non-patent literature which can be implemented now in paper form easily and inexpensively. Eventually, references provided in IDS's could be captured electronically, although this might be more costly. While examiners should make the determination if a document should be retained and added to the search files, clerical support is required to copy and actually place a document into the search files. Alternatively, applicants could be asked to submit duplicate copies of documents. We are disappointed that the agency hasn't provided the resources to do this yet.

ACCOUNTABILITY

The USPTO had a huge increase in its budget from last year to this year, i.e. FY 2000 to FY 2001. Based upon what is available for obligation, as reported in agency's FY 2002 Corporate Plan (budget), the 2001 budget is approximately 17.5% higher than the \$895 million obligated in FY 2000. We believe that it is appropriate, as part of your oversight, to look carefully at what we are getting for that money. Unfortunately, up to this point, the increase has not enabled us to meet our needed increased staffing levels. If the money is not going to increased staff, what is the money being spent on? We believe that much of the increase is going into automation.

Although the automation budget grows significantly every year, we are not seeing huge improvements in this area. As a general matter, automating the internal handling of patent application files is probably going to be a good thing. But, care needs to be taken so that it is not done in a manner that is not cost effective. It is essential that the agency be able to publish a cost benefit analysis that shows precisely what the costs of automation are to the agency and what savings are attributable to each specific automation project.

Currently, the salary cost, including the most recent increase, of all the examiners and classifiers that POPA represents in the Technology Centers is about \$220 mil-

lion. On the other hand, the budget of the Chief Information Officer is \$239 million for the current year. The trade-offs between production workers and automation programs need to be made public so that there can be an informed discussion of what is most valuable to the country.

The agency should be held accountable achieving results. When we institute new programs, a cost benefit analysis should be performed and published so that we understand whether a program is worthwhile. In order to really understand time available for examination, the USPTO needs to disclose the total time spent on overhead activities and the time that is actually spent on examination, information that is already very carefully tracked. Conspicuously absent from the agency's annual report is the number of employees on board by category, and how those employees account for their time. We recommend that the agency publish the statistics on examining time, on all examining related activities, and on overhead and supervisory activities so that the time allotted to examining can be better understood.

LABOR MANAGEMENT RELATIONS

We have lots of good news to report in the area of labor relations and employee satisfaction. I can assure you that employee morale has increased enormously. Working conditions have been significantly enhanced. Employees are delighted that a substantial pay raise has been put into effect. In addition, employees have been given significant additional flexibility in when they are allowed to do their work. Employees may now choose their work hours in a band from 5:30 in the morning to 10:00 in the evening and may choose work on one weekend day per week. Compensatory time programs may be used to shift work from one pay period to another. This flexibility makes the USPTO a particularly family-friendly environment. A casual dress policy provides a more relaxed atmosphere.

Programs to enhance the automation training for employees have been implemented. More employees are now also able to visit the laboratories and factories of applicants to get first hand knowledge of new machines and processes, and to meet inventors. The agency also provides tuition payments for both law and technical courses.

I would also like to thank the senior management at the USPTO, including Todd Dickinson, Nick Godici, Esther Kepplinger, and Clarence Crawford for implementing programs to enhance employee satisfaction and improve labor relations. The policies put into place in the past year will go a long way to enhance the recruitment of new employees and induce current employees to stay with the agency in spite of the very attractive salary packages that have been offered by many in the private sector.

The agency has also agreed to pilot a work at home program one day per week for our senior patent corps employees. Employees have been requesting inclusion in such a program for years and it will be a big selling point for recruitment and retention.

I would also like to thank the Subcommittee for placing employee organizations on the Public Advisory Committees. This gives us a sense that we are a part of the process of planning for the future, an opportunity to hear the needs of different segments of the patent community and a real opportunity to understand the origin of policies that affect us very directly.

Mr. COBLE. Thank you, Mr. Stern. Thanks to all the panelists. The 5-minute rule applies to us as well, so I will be ever diligent for the red light.

Mr. Godici, let me ask you this first. You mentioned you lost 475 examiners last year. Is that right?

Mr. GODICI. I believe it was 437.

Mr. COBLE. Of that number how many were people who retired as opposed to seeking other employment?

Mr. GODICI. I don't have those numbers off the top of my head, but it is safe to say the significant portion of those 437 were not through retirement.

Mr. COBLE. I would think not either. But at your convenience I would like to know that. And do you all—you probably don't do this, but do you track them when they leave to find out where they go? Is there any sort of pattern?

Mr. GODICI. We do an exit interview and we collect some data from those people that leave and their supervisors in terms of finding out why they left and what their rationale or reasoning was as opposed to where they went. I am not sure we have that data.

Mr. COBLE. You might give that to us also. I would like to know that.

[The material referred to follows in the Appendix.]

Mr. COBLE. Assuming, Mr. Godici, that money is not an issue, and it is, but assuming it is not, what would be the things that you would do to change the PTO operations to better serve patent and trademark filers?

Mr. GODICI. Mr. Chairman, really it boils down to three areas: We need to look at and improve quality, and I think Mr. Myrick had some very good comments with respect to quality. They included looking at the way we train our examiners, looking at the tools that we make available to our examiners and looking at some of the process changes that have been suggested by you and Ranking Member Berman, such as improvements in the reexamination process, and so on, that can help us improve quality.

The second area that we need to focus on is an obvious one, and that is timeliness, delivering a quality examination in a timely manner. Obviously one of the ways to implement that goal is to increase our staff through hiring more patent examiners, to look at efficiency gains, look at the process itself and where we can come up with gains in efficiency, Mr. Montan talked about a program we have on the trademark side for a bonus incentive system, to help us along those lines. And last but not least, with respect to timeliness, one of the most important things is to be able to not only hire but retain folks that come into the PTO so that they become more experienced, and more valuable to the organization. We have done several things, including the pay raise that we just got through OPM, to help us out there.

Last but not least, and I will move quickly, is e-government. Moving from a paper based system to an electronic based system will help us both in timeliness and the quality of the products that we put out.

Mr. COBLE. Thank you, sir.

Mr. Myrick, if the funding situation does not improve in the near term and PTO operations continue to suffer as a result, how serious is IPO about suing the government over the diversion issue, based either on takings or direct tax on property theory?

Mr. MYRICK. Thank you, Mr. Chairman. The IPO board has taken no decision on any lawsuit at this time. Such a lawsuit is premature for several reasons at this moment. But we have discussed the constitutionality of the continuing diversion of funds and have received advice from a highly qualified constitutional lawyer. We are preparing a paper on the subject to discuss with various Members of the Congress, including yourself and Mr. Berman, and the administration, all of whom we sincerely believe are at least as concerned as we are about it, the principles of the Constitution.

Moreover, we believe that the new administration and the new Secretary of Commerce in particular are looking afresh at the

needs of the PTO, and we hope that such a new look will make our constitutional concerns go away.

Mr. COBLE. That is a fair response. I talked to the President, I have talked to the Secretary of Commerce, and I suspect Mr. Berman has talked to others as well, indicating to them our very serious concern about this. So I am hoping that we will get some response.

Mr. Montan, you noted in your written testimony that more than half of the trademark respondents to a survey were displeased with refusals to register based on sections 2(d) and 2(e)(1) of the Trademark Act. Amplify this point, if you will.

Mr. MONTAN. Mr. Chairman, these are the two principal reasons that trademark applications are rejected. 2(d) is because there is a registration that is already on the register and considered confusingly similar to the application. 2(e)(1) is a refusal based upon the grounds of descriptiveness. Normally when you get an office action back from the PTO there may be some formal defects in the application that can be easily fixed. These are the two most substantive rejects that you will normally get. And the Patent and Trademark Office does its own customer survey every year, and these two refusals were identified as being areas where users of the trademark system; that is, members of INTA and other people who use the system, feel that there is a certain lack of consistency among the examiners in giving these refusals for registration.

And again, this may be because there are new examiners that need to be a little better trained. Again, many of the issues that were brought up about training and technology might help these problems.

Mr. COBLE. Thank you, sir. I have two or three more questions, but my red light is illuminating. Let me yield to Mr. Berman from California.

Mr. BERMAN. Thank you, Mr. Chairman. And I am sort of intrigued by this constitutional question. Although I am intrigued, I am not very excited by it. What is the theory that would say that a diversion of funds here as opposed to the 247 other places we divert funds, we take application fee monies or airport landing fee monies or highway gas tax monies and use them for other purposes, and are the lawyers that are giving you advice on this issue the same ones who argue that minimum wage law is an abridgement of the freedom to contract?

Mr. MYRICK. Mr. Berman, I thank you.

Mr. BERMAN. I am with you on policy, but I am not sure I am with you on the Constitution issue.

Mr. MYRICK. Let me say this, our board is very seriously considering this issue and has taken advice. The way we like to approach this, if you don't object, is we would like to give you a considered paper that has been approved by our board before we present it in public. You can imagine why. The theory is the takings clause issue and a direct tax issue, takings under the fifth amendment, and the direct tax issue, of course the Federal Government is prohibited from doing direct taxation because of the lack of representation as a direct tax.

We will provide this paper to you within a couple of weeks so if you can hold the record open and if would you like to put it in the

record, that would be fine. But I would not like to prestate or upstage my own board on giving you that full blown recital just now.

If you will bear with us, we will have that paper to you within 2 weeks.

Mr. BERMAN. Yeah. I said this at the last hearing. I mean, I said I would be interested in looking at it, but since we agree on the policy I don't want to spend a lot of time off on the constitutionality. You certainly have a right to sue. My fear is the consequence of that suit if you were successful. I am not quite sure I understand how you would be successful, but if you were successful would it be simply to lower the fees of your member associations, not to increase the ability of the Patent Office to deal with problems of pendency delays and inadequate staffing and salaries and all the other issues?

Mr. MYRICK. May I respond a bit further? Let me just advise the issue of a lawsuit has not been raised in my testimony or the testimony of IPO. We have raised the issue of constitutionality. What the appropriate approach is to resolving these issues of constitutionality is something for you to consider, for the administration to consider and for us, of course. We are not necessarily saying that any lawsuit is the appropriate vehicle. What my statement said—very important in saying—is that we believe that you at least as much as we are concerned about constitutionality of what goes on inside the Congress, and I think the administration is concerned.

What we are trying to do is to bring forward the argument that has been presented so persuasively to us that say that there is an issue here. How far that issue goes with regard to all the other agencies, we have not looked at because frankly we don't have the breadth of exposure to all those other situations. But we certainly are looking at it in the context of the PTO, and we will present you a paper that presents it in that context, from which hopefully your general counsel and so forth can extrapolate as far as those arguments need to be taken.

[The material referred to follows in the Appendix.]

Mr. BERMAN. Thank you.

Mr. Stern, I would like to ask you a question. It is a little bit off this point, but it does get to the issue of patent quality. Apparently at the present time there is no obligation for a patent applicant to conduct a prior art search. While applicants have to disclose all relevant prior art of which they are aware, they don't have any duty to actually search for relevant prior art.

Do you believe the creation of a duty to search for prior art would be helpful to examiners and improve the quality of patent applications?

Mr. STERN. I don't think that—we have not prepared on this. I have not run this by my executive—.

Mr. BERMAN. You as an individual.

Mr. STERN. But my own personal opinion on it is there is no need to place that duty. There have been so many issues about fraud in the past with respect to the enforcement of patent applications that creating that kind of a duty will create more of a cloud over patents than it will be helpful to examiners.

Mr. BERMAN. People will not—there will be debates about whether or not they actually undertook the search that we have obligated them to do.

Mr. STERN. That is a concern. I think what we would like to do is have the kind of patents that folks can rely upon. We don't want to introduce indirectly questions that will be the bases for later litigation. But we of course do want to find all the prior art, and it is very useful to have applicants who are experts in the field submit that prior art to us. And examiners do look at that. Hopefully, it will be relevant and will guide the examiner in the search for further prior art. But it is really basically our responsibility to find the relevant prior art. That is our role in the system.

Mr. BERMAN. Well, Mr. Chairman, I ignored the old adage you never ask the question unless you know what the answer is going to be. Thank you.

Mr. COBLE. I have two or three more questions. Do you have more questions as well? Let's go to a second round here. Mr. Myrick, I did not intend to steer the ship on the rocks into reefs and shoals about my question about the possible lawsuit, but you know that was mentioned last year at one of our hearings, and I think it is an issue that is significant, and that is why I broached that subject. Let me put this question to all four of you: If you have had a chance to examine 2047 in some detail, I would like to have your thoughts about the bill. Let me start, Mr. Godici, with you. I still like the title Commissioner rather than Undersecretary. Commissioner has a very vibrant ring to it to me.

Mr. GODICI. Thank you, Mr. Chairman.

Mr. COBLE. Commissioner, in your view do you think that the section 3 of the bill, the 50 million earmarked for each of the two fiscal years, do you think that will suffice to enable the office to develop a fully functional electronic filing and processing systems in the time frame proper?

Mr. GODICI. Actually, Mr. Chairman, we believe that the development of that system on the patent side is actually a 3-year program. We believe we are going to need funding for development in fiscal years 2002, 2003 and 2004, and with that funding we believe that we could deliver a system in fiscal year 2004. So as far as a time frame is concerned we believe we need the 3 years.

Mr. COBLE. As Mr. Berman said, don't ever ask a question to an answer you don't know. I was bitten as well Howard. But I think 3 years is more appropriate.

Mr. Myrick.

Mr. MYRICK. Personally I like 2 years. I don't know whether the \$50 million is the right number or not. There is no way for us to estimate that. But I think making an objective to complete such an approach in 2 years is far more desirable to us.

Mr. COBLE. Mr. Montan, do you have a view on this?

Mr. MONTAN. Again it is very hard for me to say. I would have to go along with what the Commissioner said.

Mr. COBLE. I have no magic wand about the 50 million either. Mr. Stern.

Mr. STERN. We are very strong advocates of not buying a pig in a poke, and you don't spend money on a system until you know what you are going to get for your money. And so our recommenda-

tion strongly is that we develop some plans before you authorize some money. You review the plans and then you decide whether it ought to be 50 million, 100 million or more or less. And one of the things that isn't clear in this bill is whether or not this is on top of the already huge automation budget that the agency has. If this is going to raise the level up to almost 300 million in terms of the amounts of money that the agency spends on automation, the real question is are you getting good value for your money, because we examiners are the choke point in the system, unfortunately. We can't speed up our examination in any way but to have more people doing the examination. And if you are concerned about pendency, the only way to reduce pendency is to have more examiners, not to have more computers. The additional computers will just slow down things, not increase speed.

Mr. COBLE. Let me put a two-part question to you, Mr. Stern: Whether and why PTO needs to overhaul its classification system, A, and B, how much minimum time should an examiner devote to a search?

Mr. STERN. Well, those are two very good questions. The classification system is very much in need of redoing. In the past we used to redo a class due to new developments about once every 10 years. That is not happening anymore. There are some subclasses that the number of patents is about 4,000. That makes it totally uneconomic in terms of time to go search. The patent classification system is the essential tool by which we find the prior art. And if we let that go, we are not going to do as good a job as we could if we had the patent classification system.

Mr. COBLE. Mr. Godici, I think in the sense of fairness and clarity, would you care to respond to Mr. Stern?

Mr. GODICI. With respect to classification, sir, two things: Number one, I think that in moving from a paper-based system to an electronic-based system we have to reexamine exactly what it is in terms of needs of a classification system. I think they are different in paper than they are in electronics.

Taking Mr. Stern's example, we may have a larger subclass than we had when we had to stand and flip paper documents. But if you have an electronic tool that will allow you to text-search those documents and cull them down at your desktop you may not need to actually reduce the count as you did in the paper environment.

Although I do agree with Mr. Stern, keeping our classification system robust, keeping it up to date, is essential to a quality examination, and I think it is a matter of balancing the resources we have at the PTO in ways to improve the process at the PTO to deliver the quality of examination that is needed by our applicants.

Mr. COBLE. Thank you, sir. I see that ever recurring red light. So I recognize Mr. Berman.

Mr. BERMAN. Thank you, Mr. Chairman. Forgetting again that old adage, you expressed skepticism about imposing a duty to search. What about a requirement that applicants disclose the extent to which they have searched for prior art? What do you think about that?

Mr. STERN. Well, again, the problem there is to try to trap the applicant into doing—making an admission that can later be used

in court. We would not be advocates of that. We are advocates, however, of having applicants who are experts in the field—.

Mr. BERMAN. Let me just interrupt. Why do you say that is put forth to trap patent applicants? Why isn't it put forth to help the examiners know the extent to which they need to do some—.

Mr. STERN. I think my membership is basically going to decide where they are going to search based upon their own experience. That really is our function in the system. It is our responsibility to find where the prior art is. And while we appreciate the help that we can get from patent applicants I think that we ultimately ought to be held responsible for finding the art. If we don't, we have not done a good job. Applicants because they are in the field will have some specialized knowledge. I am sure that a court can take into account what was found and what information is available at a later time that was not found without having an explicit duty on the applicant to actually present that art. If—.

Mr. BERMAN. I am not talking about now you need to present that art. I am talking about a duty to indicate what you in fact searched for and why shouldn't the court—I mean as you evaluate, why shouldn't the court have that information as part of the record in terms of reviewing the legitimacy of a patent?

Mr. STERN. If that is something that you feel is necessary and useful for the system, we certainly would not object. I mean, that I don't think is the role of the examiners in the system. But I do think that examiners do take responsibility for finding the prior art, they appreciate the help that they will get from applicants, but I don't think there is a need in the system to make that a responsibility of an applicant and make an issue later on in the enforcement process their integrity in terms of how well the applicant did a job that would undercut the applicant's position. I think that is our really our responsibility, and I think we should have the time and the resources to do it well so that others can rely upon its objectivity and the fact that it was done completely.

Mr. BERMAN. We should accept that the game is hide the ball and not put the onus on the applicant to disclose?

Mr. STERN. Well, no, we appreciate anything that the applicant discloses. But if someone later on can prove that an applicant deliberately withheld information that they knew about, that is a different situation and I think—.

Mr. BERMAN. Why, if he doesn't have an obligation to disclose what he searched for, if it is bad to deliberately withhold, why not—if it is wrong to deliberately withhold, then why isn't it helpful to know what he searched?

Mr. STERN. It may very well be helpful to know what he searched for, and from an examiner's point of view there is an expectation that we will understand that the part that we are working in and we will know where to search, and I don't think we have relied on other patent offices for their search. It is really our responsibility and I think we accept that responsibility.

Mr. BERMAN. Okay. Mr. Godici, can you tell us how you would use the 207 million or whatever it now is that the administration proposes to divert; in other words how many examiners would be hired, what salary grade, what raises would you think would be useful for retention purposes, which of the activities in the office

should those raises be granted, what projects would be completed, what would be the cost, how much would the backlog be reduced, in what time frame?

Mr. GODICI. Mr. Berman as I mentioned before, I think it is pretty clear that the USPTO stands on a stool with three legs, in terms of its goals and initiatives to improve patent quality, to improve timeliness and to move from paper to automation. Some of the specifics you are talking about with respect to hiring—as I mentioned in the oral testimony, we have just gotten within the last week a special pay scale for our patent examiner. This is about 10 percent above the previous scale.

Mr. BERMAN. What I am getting at, though, is when we go and we push for this legislation, when the appropriators or their staff people who enjoy having a source of money to spend that is over and above, you know, what otherwise might have been allocated, say these guys can even tell us what the money would go for, in other words, getting a specific—and that is the purpose of that provision of the bill, getting a plan for how you would utilize that money to meet those objectives that you have articulated and that I think we all agree on would be helpful. And I mean, I would suggest actually not, obviously, for now, but as a submission for us so that we can help you make that case, go through that process of what if the money wasn't diverted, what would we do with it, what kind of credible plan would we have to deal with all the problems that everybody talks about?

Mr. COBLE. Well, your point, Mr. Berman, is well taken because when you go to the table with the appropriators, you need to have hard, convincing evidence. And even oftentimes that doesn't prevail but it's a good point, Howard.

Mr. Stern, your comment about the \$50 million, well taken. I want to say to you specifically and to the other panelists generally, there is nothing permanently fixed in stone about the 50 million, not unlike—like a lot of legislation started, and that is why we are talking to you all today, that is why we want to hear from you subsequently. Hopefully, it will be less than that. The way this town operates that probably won't be the case, but I am the eternal optimist. But I wanted you to know there is nothing permanent or fixed about that.

I have got two or three more questions. I hate to keep you all here, but I want to run by one more time here. Let me ask Mr. Godici and the Commissioner and Mr. Myrick specifically—and if other two want to weigh in, that is all right as well. Comment, gentlemen, if you will, on any differences between the U.S. System for training patent examiners and other national systems, A, and I am told that other countries place a greater emphasis on training examiners in searching methodology, whereas our system emphasizes legal education, B.

Do you all think our examiners need to become better versed in those skills related to searching for prior art? Commissioner, why don't we start with you?

Mr. GODICI. Sure. With respect to the USPTO and its training programs, we have a patent academy where our new patent examiners are both in a classroom and on-the-job-type training that does deal with legal and procedural issues. But within the last couple

of years, we have integrated search training, use of electronic searching tools, and training to how to use those searching tools in our patent academy.

Just within the last year we have implemented a curriculum for search training, and examiners have an opportunity to enroll and sign up for classes specifically devoted to search techniques and training on the searching tools and can self-select into different levels of training within that curriculum and actually have a bank of hours that they can use to devote to training on search techniques. So I think within the last year or two, we have made some strides in terms of increasing just the type of training you are talking about.

Mr. COBLE. Mr. Myrick.

Mr. MYRICK. Thank you, Mr. Chairman. It is difficult for me to judge the differences in the training. I do know that the training of the EPO amounts to something on the order of 1-1/2 total man-years, staff years, of work in getting an examiner ready to serve his function as a journeyman examiner.

How that compares to the collective training we provide in the USPTO, I am not quite sure. But I do know there is a fundamental difference in the effectiveness of the training, because the examiners at the EPO stay a lot longer. Their tenure is very, very long, so they not only get this training but they also continue to build that training, and that tenure mounts up over the years to give us an effective value out of that training that is substantially higher, I think, than we get in the significantly rapid turnover of the examining court in the U.S.

This past year we had a big improvement in the turnover. It went from 13 percent to 9 percent—is that right—and I think a lot of that was based upon the fact that there was an improvement in the pay scale in the wings. Whether that will continue now is a question of great importance.

And one of the other proposals that we will make perhaps in a subsequent response to a question of yours is to talk about retention as being the major issue that we should focus on for the future to give real effectiveness to the training that we provide.

Mr. COBLE. Gentlemen—

Mr. STERN. I can't resist to put in a couple of words on this. Training as recently as 1996-1997 was almost nonexistent at the USPTO. Great strides have been made to add additional training. I think my membership is appreciative of that. We need lots more training. And training in the area of such strategy seminars in which we can discuss this among ourselves without having to show production for it and work on a particular case would be extremely useful, and I think the membership would appreciate that. But again that is an issue of funding, because for every hour that the Agency says we can be in training, they are not getting a patent application examined and they are very concerned about that.

Mr. COBLE. Now, Mr. Stern, you say without having to show production.

Mr. STERN. Right.

Mr. COBLE. You don't mean to say to us that showing production is not important, do you?

Mr. STERN. No. Showing production is important, but training is also important. And the training was shunted aside in past years so as to make sure that everyone was always examining patent applications.

Mr. COBLE. Mr. Montan, do you want to weigh in on this?

Mr. MONTAN. We are a trademark organization.

Mr. COBLE. All right. Mr. Berman, any other questions for you? All right, very well.

Mr. BERMAN. This is to Mr. Godici. H.R. 1332 is a bill that I am sponsoring with Mr. Boucher which allows a party to submit for the record prior art relevant to pending patent applications that uses a broad definition of prior art that can be submitted. That includes evidence of knowledge or use or public use or sale.

But the thing I specifically want to ask about, it requires that prior art submitted by third parties be considered during examination of patent. I have heard a variety of objections to this provision, not the least of which is the claim that parties can already submit such information. Can you explain to me the present situation? Are examiners currently required to consider information submitted by third parties regarding published applications, including evidence of knowledge of use, leads for additional prior art, and commentary on the relevance of submitted prior art?

Mr. GODICI. With respect to the publication of applications and the submission of prior art by a third party who might see that published application and then send it to us, we do have in place a procedure where we will consider prior art documents. We will not allow a third party to give us an explanation or a legal rationale or a treatise with respect to the applicability of that prior art, but the examiner will be forwarded that information, that prior art, and it will be considered by the examiner during the prosecution.

Now, you mentioned some other pieces of evidence such as prior knowledge or prior sale, I believe. Those types of bars to patentability are not part of the procedure that we have in place now, and specifically the AIPA, the language in the AIPA was very careful with respect to not setting up some kind of an opposition proceeding during the prosecution of an application. So we have tried to follow the language of the AIPA as it was written and passed in '99 so that we are in full compliance with the intent of the legislation.

Mr. BERMAN. But does that make sense to, in a sense, shield yourself on published patents applications from information which would be very useful to the examiner in deciding whether or not that patent should issue?

Mr. GODICI. We believe that the best quality examination and the best quality product is done only when the examiner has all of the pertinent information, pertinent prior art, in front of the examiner. And I believe that makes for the strongest patent document.

Mr. BERMAN. Well, I will try and take from that the conclusion. Thank you.

Mr. COBLE. This has been a productive oversight hearing. I thank you all for being here. Mr. Godici, Commissioner, when I asked you about how many of those lost examiners went through the retirement route, the reason I did that is it is very frustrating to me to go to the trouble and the expense of training people and

getting them operational on the line and then 5 or 6 years later see them waltz off the ship, go ashore, and go elsewhere.

Mr. BERMAN. Same thing with congressional staff, too.

Mr. COBLE. And the same thing with congressional staff, that is true. It is very frustrating.

Mr. BERMAN. Especially when they make more money than we do.

Mr. COBLE. I talked to one today that is going to do that, by the way. But if you can get that information for us, and Mr. Myrick, we look forward—if it is convenient for you and if you are comfortable doing it, sharing the report of the prospectus lawsuit.

Mr. STERN. By the way, Mr. Coble, the Agency really has made it more attractive to be an employee. In the last year, they have gone a long way to enhance the flexibility of the time in which you put in your work, and I think that has made it an extremely attractive place to work. And I think you will find that attrition will not be as significant in the future as it was in the past with the combination of those flexibilities plus the increased pay.

Mr. COBLE. That is encouraging to hear.

Mr. Myrick.

Mr. MYRICK. Yes, Chairman Coble. I thank you for the opportunity to present that paper and we will present it in the earnest good faith that we would like to bring to the attention the issue, rather than come forward with any specific action to be taken. Rather, we would like to share with you what we learned, and hope that produces the results that resolves the problem for everyone.

Mr. COBLE. That would be fine.

I almost forgot this. Congressman Gallegly, the gentleman from California who sits on our Subcommittee but was unable to be here, asked me if I would put this question to the Commissioner.

So I will read his question: Please detail for the record the PTO's current ability to manage, share and protect digital information. Further, what information technology is presently utilized in the private sector that enables major corporations to leverage digital information more effectively? Finally, how have budget constraints limited the PTO's ability to acquire this technology?

So can you respond to that, Commissioner?

Mr. GODICI. If by digital information you mean protecting or keeping secure information that is sent to us—for example, electronic filing of a patent or an electronic filing of a trademark—we certainly have systems in place that ensure that that digital information that comes into the USPTO is maintained in a database, is not lost. And on the patent side, we use PKI security for transmitting that information through the Internet to the USPTO.

I am not sure if that is the crux of the question or not.

Mr. COBLE. If you don't mind, Commissioner, you might ask one of your staffers to contact the staff.

Mr. GODICI. I will do that.

Mr. COBLE. And then you can iron that out, gentlemen. Anything further Mr. Berman?

Gentlemen, thank you all for being with us. You have contributed, obviously, very favorably to this hearing. This concludes the oversight hearing on the operations of the U.S. Patent and Trade-

mark Office, including review of Agency funding. The record will remain open for 1 week.

Thank you again to the panelists and to those in the audience who attended. The Subcommittee stands adjourned.

[Whereupon, at 3:15 p.m., the Subcommittee was adjourned.]

APPENDIX

STATEMENTS SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE HOWARD L. BERMAN, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman,

Thank you for calling this hearing—another installment in our annual review of the PTO and its operations.

As I have done at previous PTO oversight hearings, I want to commence by expressing my support for the PTO. Through its examination and granting of worthy patents and trademarks, the PTO performs a critical role in spurring technological innovation and commercial creativity. This innovation and creativity, in turn, has been the primary engine behind our information economy.

As with any entity, there is room for improvement at the PTO. I am concerned about the quality of some patents being issued, particularly business method patents. As I will explain more fully, I believe there are a variety of ways the PTO can address these quality concerns.

First, however, I want to acknowledge that many solutions to quality concerns will remain outside the PTO's grasp unless it has sufficient resources to implement those solutions.

The Bush Administration's budget request for fiscal year 2002 planned to divert \$207 million in FY 2002 PTO fees to programs outside the PTO. Though the past two Administrations also engaged in similar "legalized larceny," as the Chairman likes to call it, the Bush budget proposes to divert almost twice the amount diverted by any previous administration. While revised revenue estimates from the PTO indicate that the actual diversion may be far less than \$207 million in fiscal year 2002, the Bush budget also proposes to divert an average of over \$180 million in succeeding years.

These diversions are cumulative and, in effect, constitute a budgetary "shell game" played at the expense of the PTO, the country's inventors, and our economy. For example, while the fiscal year 2002 Bush budget allows the PTO to spend \$282 million diverted from fiscal year 2001 fees, it only allows the PTO to spend \$857 million of the \$1.346 billion in fees it projected would be collected in FY 2002. In other words, the Bush budget denies the PTO the ability to spend \$489 million of FY 2002 fees in FY 2002—an amount equal to the \$282 million in diverted FY 2001 fees plus an additional \$207 million in new diversions. To keep up with the shell game, next year the Bush budget will allow the PTO to expend these \$489 million in "unused" FY 2002 fees, but will divert an equal or larger amount from FY 2003 fees. Depending on actual FY 2002 fees received by the PTO, by the end of next year, the cumulative diversion could be nearly \$900 million!!

While the balance sheets of PTO revenues, budget authorities, and carry-overs are confusing, one thing is quite clear: the diversions constitute a Tax on Innovation. This "Innovation Tax" takes fees paid by inventors and businesspeople to secure patents and trademarks and uses them as an interest-free loan to promote unrelated programs. *It is at least slightly ironic that an Administration so intent on cutting taxes and promoting free enterprise would institute such an enormous Tax on Innovation.*

This Innovation Tax is leaving the PTO unable and unequipped to perform its very critical mission.

As I'm sure we will hear in today's testimony, the number of patent and trademark applications has skyrocketed over the past few years—up 50% since 1996. Patent pendency—the length of time between when an applicant first turns in her paperwork and when her patent is granted—has increased as well. The average pendency in 1996 was 21 months; now it is 25.5—an increase of over 20%. The recent strategic plan issued by the Department of Commerce projected that patent

pendencies would increase to 38 months by 2006. Remarkably, the Department of Commerce arrived at this 38 month figure using the entirely unrealistic assumption that the PTO would have access to all of its fees between 2002 and 2006—an assumption in direct contradiction with the previously released Bush budget.

Pendency can only be reduced through streamlining the process and increasing the numbers of examiners. But without adequate funding, the PTO has been forced to defer improvements in their IT processes, and attrition in their workforce was the highest in ten years during the last full fiscal year—as a result of low salaries and a hot economy. Talented people can and do go elsewhere when the government cannot pay competitive salaries. And without talented people, pendency increases and quality suffers when workload goes up.

I believe Congress should repeal the Innovation Tax by ensuring that the PTO can use all the fees it receives. Rep. Boucher and I introduced H. Res. 110 several months ago to accomplish this very goal. H. Res. 110 creates a point of order against floor consideration of any bill that provides the PTO with less than full funding. While points of order are, of course, waivable, H. Res. 110 would provide interested parties with a Rules Committee forum in which to battle waivers and resulting PTO fee diversions. Furthermore, H. Res. 110 enjoys the benefit of requiring adoption only by the House.

H.R. 2047, the bill Chairman Coble and I introduced yesterday, also advances the goal of legislating full PTO funding by authorizing the PTO to use all the fees it collects in fiscal year 2002. H.R. 2047 establishes a good precedent of authorizing the PTO to spend all that it collects, and also requires appropriators to justify why they will appropriate less than the full authorization. I believe that H.R. 2047 and H. Res. 110 are symbiotic, and I will pursue House passage of both.

I want to be clear about the difficulties inherent in any attempt to legislate full funding. Without significant, sustained support from affected PTO users, the prospects for repeal of the Innovation Tax are dim. I applaud the 21st Century Intellectual Property Coalition for sending letters asking appropriators to adequately fund the PTO. I also applaud the National Treasury Employees Union for generating grass roots pressure on key appropriators to allow the PTO to retain its fees. But, as I have said before, these efforts will come to naught unless the affected parties put the same effort into this battle as they do into their highest legislative priorities. Coalition letters and trade association lobbying must be coupled with direct appeals from CEOs, more grass roots involvement, and an expansion of organizations involved.

The PTO also has a role to play in enabling its supporters to effectively advocate for repeal of the innovation tax. The PTO needs to clearly and specifically outline how it would use all the fee revenue to be diverted. H.R. 2047 would generate this information by requiring the PTO to provide it to Congress.

While more money will certainly help the PTO fulfill its mission, it will not by itself address all patent quality concerns. I believe that a variety of reforms, particularly within the examination process, would significantly improve confidence in patent quality.

One reform would be effectuated by H.R. 2047, the bill Chairman Coble and I just introduced. Currently, the PTO can accept electronically filed patent applications, but then examines these applications in hard copy. Such a system not only creates unnecessary administrative costs, but also effectively prevents pending applications from becoming a useful source of prior art. H.R. 2047 would require the PTO to establish a system enabling it to electronically process, maintain, and search patent applications. After creation of such a system, an examiner of a business method patent application could scour for prior art all pending business method patent applications, which currently outnumber business method patents actually granted.

Another needed reform is a requirement that patent applicants disclose their prior art searches. This idea, which was encapsulated in two bills Rep. Boucher and I introduced, H.R. 1332 and 1333, ensures that patent examiners have the best available information as to likely places to search for prior art. As I understand it, over half of patent examiners have less than two years of examination experience. In other words, many have not been on the job long enough to develop refined search skills or comprehensive knowledge of their art area, much less knowledge of related art areas, or a grasp of all the literature available. Creation of a duty to disclose searches would allow inexperienced examiners to benefit from the knowledge and search skills of more experienced patent agents and attorneys.

Some have criticized the idea of a duty to disclose searches on the basis that the law does not require prior art searches, so in some cases such a duty will result in no additional information. To these critics, I have two responses. First, any additional information is better than none. Second, I would be glad to entertain proposals to create a duty to conduct prior art searches.

In slightly different ways, both H.R. 1332 and 1333 created presumptions of obviousness for mere computer implementations of prior inventions. I continue to believe such a presumption is a key reform in the examination process. Creation of such a presumption would give the inexperienced examiner, who may have a software background or a business background, but not both, needed direction to reject certain unworthy applications that they would otherwise feel constrained to approve.

Last but not least, I believe every step should be taken to ensure that all relevant prior art is available during the examination process. To this end, I believe mechanisms are needed to allow third parties to present and explain to the PTO prior art that may be relevant to pending applications. Current law and regulations restrict the scope of relevant information that third parties can present, as well as restricting the ability of third parties to explain the relevance of that information. H.R. 1332 would expand the ability of third parties to present prior art to the PTO regarding published business method application. This principle could, and perhaps should, apply to all published applications regardless of art area.

In conclusion, I look forward to hearing our witnesses' opinions on solutions to the funding issue and on ways to improve PTO operations. To the extent they can address any of the specific issues I have raised, I would appreciate it.

I yield back the balance of my time.

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF MICHIGAN

The U.S. Patent & Trademark Office always has played a crucial role in America's economy. The last decade has seen an unprecedented boom in technology, due mainly to the invention of new technologies and patents granted on them by the PTO. The importance of patents to technological advancement is evidenced by the fact that this year has seen a 13% increase in the number of patent applications. As our economy grows and technology advances, our oversight over the PTO becomes even more important.

Past oversight indicated that we needed to streamline the PTO. We were able to accomplish that to a certain extent with the American Inventors Protection Act of 1999. Among other things, the bill restructured the agency to make it more efficient and effective at examining patents and registering trademarks. Unfortunately, the PTO still faces obstacles to becoming completely efficient.

As you all may be aware, the PTO takes no money from taxpayers; instead, it is fully funded by user fees and generates approximately \$1 billion per year in revenues from those fees. This success has been an Achilles' heel—appropriators take advantage of the revenues and treat the PTO as a cash cow, diverting hundreds of millions of dollars of fees every year for other government programs. That diversion is making it exceedingly difficult for the PTO to hire or even retain qualified examiners.

But these are not just concerns about personnel and efficiency—there are real world issues. The lack of resources has caused the time period between the filing of a patent application and a final decision on it to grow from 19.5 months to 26 months in just a few years and is expected to be 38.6 months by 2006. At that rate, inventions will be obsolete by the time they're patented. Our technological advancement and our economy can only suffer if Congress and the Administration sit idly by while this happens.

Fortunately, Chairman Coble, Ranking Member Berman, and I have worked on several pieces of legislation to address these issues and hope to work with other interested parties to secure their enactment into law.



STATEMENT OF COLLEEN M. KELLEY
NTEU NATIONAL PRESIDENT
TO THE HOUSE JUDICIARY SUBCOMMITTEE
ON COURTS AND INTELLECTUAL PROPERTY

NTEU represents more than 2,700 employees in two bargaining units at the U.S. Patent and Trademark Office (PTO). These Patent and Trademark Office employees play a critical role in the development of new industries in our economy. PTO's employees perform the quasi-judicial function of adjudicating patent and trademark applications. The American public and business community place great importance on the registration of patents and trademarks in the United States as a key to the protection of valuable intellectual property rights.

PTO continues to receive an increasing number of patent and trademark applications and these applications are ones of increasing complexity. Agency management and the American public are very fortunate to have the young, progressive and innovative workforce represented in NTEU's bargaining units. They are extremely computer literate, professionally savvy and open to new ideas.

However, PTO is grossly understaffed for the growing workload it bears. Pendency for applications is at unacceptable levels. Turnover is at a magnitude that robs PTO of experienced workers and lengthens pendency because of the resources that must be diverted to new employee training.

Congress must often grapple with difficult problems with no readily apparent solution. The issue at PTO is NOT one of those situations. The solution is obvious. PTO collects fees from its customers to pay the cost of processing their applications. If these fees were fully retained by the agency, it would have sufficient resources to make the agency run the right way and have the staff it needs to do its job. This is not a matter of using taxpayer dollars to run PTO. It is using the fees paid by applicants, who have clearly expressed their willingness to pay these fees if they can have their trademark and patent applications processed in a proper and timely fashion.

Unfortunately, rather than make attempts to resolve these problems, the Administration's proposed budget makes matters worse. The Department of Commerce's PTO FY 2002 budget request has \$207 million in fee collected revenue transferred to the General Fund and cut staff by 700 positions. We find this an inappropriate use of user fees and something that is severely damaging to the

operations of PTO. This rightful and needed revenue should be used to give PTO customers better service, to meet the growing challenges of the Office and to hire the additional staff that is so needed to handle both the backlog of applications and the continuing increases. The \$207 million raid on PTO is unprecedented. Never before has this amount of money been taken away from the agency. This must stop and it must stop this year.

The impact of the Administration's budget is clear. Trademark applications would climb from 6.6 months to 8.0 months for first action and from 19 months to 20 months for final resolution. Patent pendency would go from 26.2 months to 26.7 months. Customer satisfaction at PTO would decrease 6%.

The founding fathers of our nation directed the federal government "*to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries*" (Article I, § 8, The Constitution of the United States). Congress has the obligation to take this constitutionally mandated duty seriously by providing the needed resources to protect the inventions and trademarks of American business and inventors. Diverting funds paid by these business and inventors to other, unrelated purposes while the agency is forced to make massive cutbacks in staff and reduce pendency is simply wrong.

NTEU believes that no fees collected for patent and trademark applications should be diverted for other purposes and that PTO should be given an appropriation that reflects this. We believe both Representative Berman's H. Res. 110 and Chairman Coble's HR 2047 would be useful steps in that direction. I hope NTEU can count on the Judiciary Committee's support on this important issue.

MATERIAL SUBMITTED FOR THE HEARING RECORD

Attrition Types as Percentage of Total Attritions

FY 96 Attrition Type	Count	Percent of Total Attrits
Resigned	143	75.26%
Retired	26	13.68%
Terminated	4	2.11%
Deceased	1	0.53%
Transfer to non-production	16	8.42%
	190	

FY 97 Attrition Type	Count	Percent of Total Attrits
Resigned	206	86.19%
Retired	13	5.44%
Terminated	7	2.93%
Deceased	2	0.84%
Transfer to non-production	11	4.60%
	239	

FY 98 Attrition Type	Count	Percent of Total Attrits
Resigned	220	84.94%
Retired	17	6.56%
Terminated	6	2.32%
Deceased	3	1.16%
Transfer to non-production	13	5.02%
	259	

FY 99 Attrition Type	Count	Percent of Total Attrits
Resigned	298	79.47%
Retired	15	4.00%
Terminated	26	6.93%
Deceased	4	1.07%
Transfer to non-production	32	8.53%
	375	

FY 00 Attrition Type	Count	Percent of Total Attrits
Resigned	381	87.19%
Retired	15	3.43%
Terminated	15	3.43%
Deceased	0	0.00%
Transfer to non-production	26	5.95%
	437	

FY 01 (as of 5/31/2001) Attrition Type	Count	Percent of Total Attrits
Resigned	134	79.76%
Retired	12	7.14%
Terminated	9	5.36%
Deceased	0	0.00%
Transfer to non-production	13	7.74%
	168	

Retirement Attritions as Percentage of Average Staff

Average Staff for FY: 2,264

Retirements as % of Avg. Staff: 1.15%

Average Staff for FY: 2,348

Retirements as % of Avg. Staff: 0.55%

Average Staff for FY: 2,557

Retirements as % of Avg. Staff: 0.66%

Average Staff for FY: 2,995

Retirements as % of Avg. Staff: 0.50%

Average Staff for FY: 3,174

Retirements as % of Avg. Staff: 0.47%

Average Staff for FY: 3,151

Retirements as % of Avg. Staff: 0.38%

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June 7, 2001

Blaine Merritt
 House Judiciary IP Subcommittee
 B351-A Rayburn House Office Building
 Washington, DC 20515

Dear Blaine:

Attached is a copy of pages 4 and 5 of the USPTO's "fiscal year 2002 corporate plan" dated April 2001. The data for fiscal year 2006 is referred to in Mr. Myrick's statement and perhaps in other statements.

We suggest pages 4 and 5 be made a part of the hearing record.

Sincerely,



Herbert C. Wamsley
 Executive Director

Fiscal Year 2002 Performance

Following are key workload estimates, performance indicators, and/or results for the Patent and Trademarks Businesses that will be achieved at the requested funding level. (See Appendices A-D on the Patent and Trademark Businesses, Intellectual Property Leadership and Corporate Support for additional fiscal year 2002 performance measures.) It is important to note that the performance measures identified for fiscal year 2003 to fiscal year 2006 assumes that the USPTO will receive full access to its fees in order to hire staff in critical areas and make performance-enhancing investments in automation to achieve these performance levels.

Fiscal Year 2002 Corporate Plan - April 2001

Workload/Performance Indicator	FY 2000 Actual	FY 2001 Estimate	FY 2002 Estimate	FY 2003 Estimate	FY 2004 Estimate	FY 2005 Estimate	FY 2006 Estimate
Patents							
Utility, Plant and Reissue (UPR) Patent Applications Filed	293,244	328,400 ²	367,800	404,600	445,100	489,600	538,600
EOY Pending Applications Awaiting Examiner Action	256,520	367,900	511,500	670,500	848,260	1,060,700	1,293,600
UPR Disposals	234,344	226,700	223,500	225,700	248,500	269,400	279,700
Patents Granted	165,504	166,100	166,500	157,600	165,600	181,000	192,400
Pendency - First Action (months)	13.6	14.1	17.4	19.9	22.9	26.0	28.8
Patents - Issue/Abandonment (months)	25.0	26.2	26.7	30.0	32.5	35.5	38.6
Percent of applications received electronically	N/A	2	2	10	30	50	75
Percent of allowed applications with a material or significant defect	6.6	5.5	5.5	5.5	5.0	4.0	3.0
Percent of allowed applications where a significant question relating to quality of the examination process was raised	7.7	7.0	7.0	7.0	6.0	5.5	5.0
Percent of customers satisfied overall	64	67	64	67	70	75	80
Trademarks							
Applications Received - classes	375,428	450,000	540,000	621,000	714,000	821,000	944,000
EOY Pending Applications Awaiting Examiner Action	166,300	167,200	177,300	189,800	212,100	244,000	285,700

² Does not include 6,600 patent applications refiled as a result of the enactment of the American Inventors' Protection Act of 1999.

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July 3, 2001

The Honorable Howard Coble
 Chairman
 Judiciary Subcommittee on Courts,
 the Internet, and Intellectual Property
 House of Representatives
 Washington, DC 20515

Dear Mr. Chairman:

To follow up on my testimony before the Subcommittee on June 7, I am enclosing a memorandum on the constitutionality of withholding and diversion of PTO fees. If possible, we suggest that this memorandum be included in the record of the hearing.

Sincerely,

Ronald E. Myrick

Ronald E. Myrick
 President

cc: Honorable Howard L. Berman

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MEMORANDUM

TO: Intellectual Property Owners Association
FROM: Carter G. Phillips *Carter G. Phillips*
RE: Constitutionality of Congressional Withholding and Diversion of PTO Fees
DATE: June 26, 2001

This memorandum assesses the constitutionality of the government's collection of fees from patent applicants and owners that are withheld from the Patent and Trademark Office ("PTO") and diverted to the general treasury of the United States. Over the last decade, an increasing portion of the fees that patent applicants and owners have paid has been withheld and diverted in this manner. We conclude that the collection of PTO fees that are so diverted is an unconstitutional taking, as well as an unconstitutional direct tax. It is our understanding that this memorandum will be used to apprise parties who are interested in the PTO's operation of the unconstitutionality of the practices involving PTO fees.

I. The Federal Government Has Withheld From the PTO and Diverted to the General Revenue an Increasing Share of Fees Collected by the PTO From Patent Applicants and Owners

The PTO derives its operating funds from fees paid directly to the PTO by patent and trademark applicants and owners. Indeed, the PTO is entirely funded by such fees. *See* FY 1995 PTO Annual Report at 41 ("All operating costs [of the PTO] are now funded by the collection of user fees"). In the case of patents, the PTO collects, *inter alia*, application fees, issuance fees, and maintenance fees. *See* 35 U.S.C. § 41. The fee amounts are set by Congress, although the PTO is empowered to adjust them in certain circumstances. *See* 35 U.S.C. § 41(f). At present, for example, the application fee for a utility patent is \$710; the issuance fee for a utility patent is \$1,240; and the three maintenance fees are \$850 at 3½ years, \$1,950 at 7½ years, and \$2,990 at 11½ years. *See* 35 U.S.C. § 41(a).

When the PTO receives fee payments, they are credited to its appropriation account in the Treasury Department. *See* 35 U.S.C. § 42(b). These fees are made available to

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the PTO to fund its activities "[t]o the extent and in the amounts provided in advance in appropriations Acts." 35 U.S.C. § 42(c). Since 1992, Congress has made an increasing share of the fees collected by the PTO unavailable for the PTO's use. Specifically, Congress imposed a surcharge on PTO fees in fiscal years 1991 through 1998. The surcharges collected in fiscal years 1992 through 1998 were required by statute to be credited "to a separate account established in the Treasury and ascribed to the [PTO's] activities in the Department of Commerce as offsetting receipts." 104 Stat. 10101 (1990), *amended by* 107 Stat. 8001 (1993). These funds are "available only to the [PTO] . . . to the extent provided in appropriation Acts," and "remain available until expended." *Id.* At the end of fiscal year 1998, when the statutorily authorized surcharge expired, this account held \$233,500,000. *See* FY 1999 PTO Annual Report at 41. These funds have been withheld from the PTO.

In fiscal years 1999 through 2001, Congress abandoned the mechanism of a surcharge and withheld PTO fees through a slightly more complicated means. In fiscal year 1999, Congress authorized the PTO to spend \$745,026,000 of the \$875,800,000 collected in that year, as well as \$66,000,000 collected in 1998. *See* 112 Stat. 3272 (1998). In fiscal year 2000, the PTO was authorized to spend \$755,000,000 of the \$1,006,000,000 collected in that year, in addition to \$116,000,000 collected in fiscal year 1999. *See* 113 Stat. 1501 (1999). This practice will continue through fiscal year 2001, as Congress authorized the PTO to spend \$783,843,000 of the \$1,152,000,000 expected to be collected in that year. *See* 114 Stat. 2762A-174 (2000). The PTO was also authorized in 2001 to spend \$254,889,000 collected in fiscal years 1999 and 2000. *See id.*

The result of this practice is that a significant share of the fees collected by the PTO has been withheld from the PTO. Various entities have prepared estimates of the cumulative impact of such withholding, with differing results. *See, e.g.,* Budget of the United States Government, Fiscal Year 2002, Appendix (estimating a balance of \$664,000,000 in "Unavailable Collections" in 2001); PTO Patent Public Advisory Committee, Annual Report at 9 (Nov. 30, 2000) (estimating that \$337,000,000 has been or will be made unavailable to the PTO in fiscal years 1999 through 2001); Testimony of Ronald E. Myrick, President, Intellectual Property Owners Association, before the House Judiciary Subcommittee on Courts and Intellectual Property, Appendix B (March 9, 2000) (estimating that \$570,000,000 has been or will be withheld from the PTO from 1992 through 2001). While the total dollar amounts of these estimates vary, their import is the same: a considerable portion of the fees collected by the PTO has been and continues to be withheld from the PTO.

Moreover, it is our understanding that a significant amount of the fees withheld since 1992 has been diverted from the PTO and used for purposes unrelated to the administration of the patent system. For example, in fiscal year 1999, \$71,000,000 in fees collected by the PTO in 1999 and previous years were rescinded from the PTO and used for purposes unconnected to the PTO. *See* 112 Stat. 2681 (1998). The legal analysis in this memorandum proceeds on the understanding that a considerable segment of the fees withheld has been diverted away from the PTO to unrelated government accounts and programs.

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II. The Federal Government's Practice of Withholding and Diverting Fees Collected by the PTO Violates the Takings Clause of the Fifth Amendment to the United States Constitution

The Fifth Amendment to the United States Constitution provides that private property may not "be taken for public use, without just compensation." U.S. Const., amend. V. The bedrock principle enshrined in the Takings Clause is simple and familiar: the government may not "forc[e] some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960). Yet this is precisely what the federal government has done to patent applicants and owners, for it has imposed undue fees on this relatively narrow class of entities to fund programs that benefit the general public. By withholding and diverting from the PTO a portion of the very fees that are assessed to fund the PTO, Congress has demonstrated that the fees the PTO charges are excessive and constitute an uncompensated taking of the property of patent applicants and owners.

A. Supreme Court Precedent Demonstrates That the Withholding and Diversion of Fees Collected by the PTO Violates the Takings Clause Because the Fees Collected Demonstrably Exceed the Cost of Administering the PTO and Are Used to Fund Unrelated Government Programs

The Supreme Court has ruled that the government may not force users of a particular government service to pay fees that significantly exceed the cost of that service and may not use those fees to underwrite unrelated government programs. In *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), the Court considered the constitutionality of a Florida statute that authorized the state to keep the interest earned on funds deposited with the state court. A party had filed a complaint of interpleader in state court and paid the court nearly \$2 million to protect itself from certain liabilities, and the court had deposited this money in an interest-bearing account. The court ultimately retained over \$9,000 of the \$2 million to reimburse itself "for services rendered" in connection with the proceedings. *Id.* at 158. But, as authorized by statute, it also retained over \$100,000 in interest earned on the \$2 million. The party that paid the money alleged that the Florida court's retention of the interest was unconstitutional.

On appeal, the Supreme Court held that the statute allowing the Florida court to retain the interest on the deposited funds violated the Takings Clause. The Court first recognized that "[t]he principal sum deposited in the registry of the court plainly was private property." *Id.* at 160. Moreover, the interest "was not a fee for services," since the \$9,000 charge reimbursed the state for any efforts it expended. *Id.* at 162. By keeping the money, the Florida court had not merely "adjust[ed] the benefits and burdens of economic life to promote the common good." *Id.* at 163 (quoting *Penn Central Transp. Co. v. New York City*, 328 U.S. 104, 124 (1978)). Rather, it had exacted "a forced contribution to general governmental revenues" that was "not reasonably related to the costs of using the courts." *Webb's Fabulous Pharmacies*, 449 U.S. at 163. Such an exaction, the Court held, was unconstitutional.

The Supreme Court revisited the issue of the constitutionally required relationship between the amount of a fee for using government services and the cost of providing those

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services in *United States v. Sperry Corp.*, 493 U.S. 52 (1989). In *Sperry*, the Court faced a statute enacted in the aftermath of the Iran hostage crisis. That statute required the Treasury Department to retain 1 ½ percent of any award made to an American claimant by the Iran-United States Claims Tribunal. This deduction was intended to reimburse the federal government for expenses it incurred in resolving claims against Iran. A party who received an award through the Claims Tribunal and was required to pay this fee challenged its constitutionality under the Takings Clause.

The Court's decision in *Sperry* is significant in several respects. First, as in *Webb's Fabulous Pharmacies*, it recognized that payment of money to the government may be the subject of a takings claim. "Money is fungible," according to the Court, and "[n]o special constitutional importance attaches to the fact that the Government deducted its charge directly from the award rather than requiring Sperry to pay it separately." *Sperry*, 493 U.S. at 62 n.9.

Second, the Court made clear that a user fee may constitute a taking if it does not directly reimburse the government for services rendered. *See id.* at 63 ("a reasonable user fee is not a taking if it is imposed for the reimbursement of the cost of government services"). Of course, the government may "mak[e] those who specifically benefit from its services pay the cost." *Id.* at 63 (quoting *Massachusetts v. United States*, 435 U.S. 444, 462 (1978) (plurality opinion)). But a fee violates the Takings Clause if it significantly exceeds the cost of the government services. Indeed, the Court cited *Webb's Fabulous Pharmacies* for the proposition that user fees may be "so clearly excessive as to belie their purported character as user fees." *Sperry*, 493 U.S. at 62. Rather, a fee must constitute a "fair approximation of the cost of benefits supplied." *Id.* at 60 (quoting *Massachusetts*, 435 U.S. at 463 n.19). The Court determined that the 1 ½ percent deduction at issue satisfied this test.

Under the reasoning of *Webb's Fabulous Pharmacies* and *Sperry*, it is often difficult to show that a fee is so clearly excessive, or so unrelated to the government's cost in providing benefits, that it is not a "user fee." *See, e.g., Marshall County Bd. of Educ. v. Marshall County Gas Dist.*, 992 F.2d 1171, 1176 (11th Cir. 1993) (rejecting a takings challenge because "the plaintiffs received fair value in exchange for their payment"); *Commercial Builders of N. Cal. v. City of Sacramento*, 941 F.2d 872, 876 (9th Cir. 1991) ("[a] purely financial exaction . . . will not constitute a taking if it is made for the purpose of paying a social cost that is reasonably related to the activity against which the fee is assessed"). But that is not the case with respect to the fees charged by the PTO. Congress has made clear that the purpose of these fees is to reimburse the PTO for the costs of administering the system for obtaining and maintaining patents. *See, e.g., 35 U.S.C. § 42* ("All fees paid to the Commissioner and all appropriations for defraying the costs of the activities of the [PTO] will be credited to the [PTO] Appropriation Account in the Treasury of the United States"); S. Rep. No. 99-305, at 5 (1986), *reprinted in* 1986 U.S.C.A.N. 5884, 5888 ("patent applicants and those seeking to register trademarks should bear a significant share of the cost of operating the [PTO] by the payment of fees") (internal quotations and citation omitted); H.R. Rep. No. 102-382, at 7 (1991), *reprinted in* 1991 U.S.C.C.A.N. 1320, 1322 ("the Budget Reconciliation Act of 1990 . . . converted the [PTO] from a partially user fee funded agency to one almost entirely funded by user fees"). Yet Congress' own actions demonstrate that a significant portion of these fees indisputably exceeds the cost of administering that system and is unnecessary to fund it. *See supra* at 1-2. By definition, the

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withholding and diversion of fees from the PTO *necessarily* reflects Congress' own judgment that the fees collected by the PTO exceed the amount necessary to fund the agency. Thus, Congress itself has provided direct evidence that the PTO's fee collections do not roughly approximate the PTO's cost of providing its services. There is no conclusion but that the fees withheld and diverted are "so clearly excessive as to belie their purported character as user fees," *Sperry*, 493 U.S. at 62, and are in fact a "forced contribution to general government revenues," *Webb's Fabulous Pharmacies*, 449 U.S. at 163. There is no conclusion, in short, but that the collection of fees that are withheld and diverted constitutes an uncompensated taking.

B. The Government's Practice of Withholding and Diverting Fees Differs From Those Considered by the Circuit Courts That Have Applied *Webb's Fabulous Pharmacies* and *Sperry*

The unique circumstances surrounding the collection of PTO fees readily distinguish these fees from those at issue in many circuit court decisions applying *Webb's Fabulous Pharmacies* and *Sperry*. Indeed, appellate court decisions reflect a strong reluctance to second-guess congressional judgments concerning the amount of fees necessary to fund a government program. Here, by contrast, Congress itself has made the judgment that a significant portion of the fees collected from patent owners and applicants is excessive and unnecessary.

For example, in *Colorado Springs Production Credit Association v. Farm Credit Administration*, 967 F.2d 648 (D.C. Cir. 1992), the D.C. Circuit upheld a statutory requirement that certain farm credit institutions make disproportionately large payments to a corporation designed to ensure the solvency of the entire farm credit system. The financial institutions argued that taxpayers and other institutions should have contributed more to the system because it benefited the general public. But the court determined that the payers "derived benefit from the Act roughly commensurate with the burdens they were forced to bear," and noted that "the judiciary is not institutionally fitted" to determine whether Congress appropriately allocated financial burdens among eligible parties. *Id.* at 654-56. It stated that "the comparison between benefit and burden need not be made with mathematical precision," so long as "the government provides the burdened party with benefits that are a fair approximation of the value that it has relinquished." *Id.* at 656 (internal quotations and citation omitted).

Similarly, in *Student Loan Marketing Association v. Riley*, 104 F.3d 397 (D.C. Cir. 1997), the court upheld a fee imposed on loans issued by Sallie Mae to guarantee payment on defaulted loans. The court cited *Sperry* for the proposition that, "[i]f the regulatory action in question benefits the burdened persons and the amount of the burden is a fair approximation of the costs of benefits supplied, then no taking is said to have occurred." *Student Loan Marketing Ass'n*, 104 F.3d at 402 (internal quotations and citation omitted). Determining that Sallie Mae received specific benefits from its involvement in the federal student loan program, the court held that these advantages bore a "rough equivalency" to the costs imposed by the offset fee. *Id.* at 404. Like the court in *Colorado Springs*, it rejected the argument that Congress had "unjustly burdened [the payer]" with obligations that other parties should have shouldered. *See Student Loan Marketing Ass'n*, 104 F.3d at 40. *See also Jorling v. Department of Energy*, 218 F.3d 96, 103, 107 (2d Cir. 2000) (holding that "a method for imposing charges based on each payer's approximate use will pass muster as an adequate apportionment of costs," but assuming that a fee would be unreasonable if the payer "could show that its fees significantly exceeded the actual

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cost of services”); *Meriden Trust & Safe Deposit Co. v. Federal Deposit Ins. Co.*, 62 F.3d 449, 454-55 (2d Cir. 1995) (examining the economic impact of the regulation on the claimant; the extent to which the regulation interfered with the claimant’s reasonable investment-backed expectations; and the nature of the governmental action, in evaluating takings claim involving cross-guarantee liability for bank losses); *Brock v. Washington Metro. Area Transit Auth.*, 796 F.2d 481, 485 (D.C. Cir. 1986) (the method used to calculate a permissible user fee “must rationally be designed to approximate prospectively the benefit to the user”).

In these cases, the courts determined whether the burdened party received any benefit, and whether the full amount of the money exacted was used to provide that benefit. If so, the courts deferred, under the “rough approximation” standard, to Congress’ judgment concerning the amount of the fee necessary to provide the government service and the allocation of the financial burden imposed. By contrast, a significant portion of the payments to the PTO do *not* relate to the cost of administering the patent system. Rather, hundreds of millions of dollars paid by applicants for, and owners of, patents are withheld from the PTO by Congress and diverted to fund nameless government programs. A challenge to the collection of these diverted fees, therefore, would not require any judicial second-guessing of Congress’ judgment concerning the level of fees necessary to fund the patent system. Congress itself has determined that diverted fees are unnecessary to fund that system. Nor would such a challenge call into question Congress’ determination of who should bear the cost of funding the PTO. It is plainly equitable and appropriate for patent applicants and owners to pay fees necessary to fund the government’s costs in providing a patent system. But those applicants and owners plainly should not—and cannot be required to—pay fees used to fund other programs unrelated to that system. The Takings Clause violation is thus readily apparent.

III. The Federal Government’s Practice of Diverting Fees Collected by the PTO Violates Article I, § 9 of the United States Constitution by Imposing a Direct Tax on Patent Applicants and Owners

Article I of the Constitution provides that “No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.” U.S. Const., art. I, § 9, cl. 4. This means that, for Congress to impose a direct tax, it must set the taxation rate on a state-by-state basis, ensuring that each state’s contribution to the total tax revenue is proportional to its share of the national population. By imposing fees on patent applicants and owners and then diverting a portion of those fees to the general revenue, Congress has unconstitutionally levied a direct tax on users of the PTO.

A. Supreme Court Precedent Demonstrates That It Is Unconstitutional for Congress to Impose a Direct Tax on Personal Property

The Supreme Court long ago determined that a tax on personal property can be an unconstitutional direct tax under Article I, § 9. In 1895, the Supreme Court rendered two decisions in *Pollock v. Farmers’ Loan & Trust Co.*, 157 U.S. 429 (1895), and 158 U.S. 601 (1895), concerning the constitutionality of a federal income tax. In the first case, the Court held that the unapportioned direct taxation of income from real estate was unconstitutional. 157 U.S. at 581. In the second, the Court held that the unapportioned direct taxation of income from

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personal property, like an unapportioned tax on personalty itself, was also unconstitutional. 158 U.S. at 618, 628-29. The Sixteenth Amendment reversed the result in *Pollock*, empowering Congress “to lay and collect taxes on *incomes*, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.” U.S. Const., amend. XVI (emphasis added). The amendment, however, did not change the definition of a “direct tax,” and it did not empower Congress to tax the mere possession of real or personal property.

The venerable principle of *Pollock*—that a direct tax on possession of personal property is unconstitutional—has been recognized by the circuit courts on numerous occasions. See, e.g., *Shoffeitt v. United States*, 403 F.2d 991, 992 (5th Cir. 1968) (“[a] tax on possession of property would likely run afoul of the limitations on direct taxes set forth in Sections 2 and 9 of Article I of the Constitution as construed by . . . *Pollock*”); *Simmons v. United States*, 308 F.2d 160, 166 (4th Cir. 1962) (“A direct tax is a tax on real or personal property, imposed solely by reason of its being owned by the taxpayer”); *Richardson v. United States*, 294 F.2d 593, 596 (6th Cir. 1961) (recognizing that the Sixteenth Amendment “was restricted to income, leaving in effect [*Pollock*’s] limitation upon direct taxation of principal”); *Penn Mut. Indem. Co. v. Commissioner of Internal Revenue*, 277 F.2d 16, 19-20 (3d Cir. 1960) (“the requirement for apportionment is pretty strictly limited to taxes on real and personal property and capitation taxes”); *Peak v. Commissioner of Internal Revenue*, 80 F.2d 761, 762 (8th Cir. 1936) (“if a tax is laid on property which is not income, it cannot be sustained, for that would be to levy a direct tax requiring apportionment”); *Alexander Theatre Ticket Office v. United States*, 23 F.2d 44, 46 (2d Cir. 1927) (tax on “incident of ownership of [a theatre ticket] as such” would be an unconstitutional direct tax); *Mellon v. Minneapolis, St. Paul & S.S.M. Ry. Co.*, 11 F.2d 332, 335 (D.C. Cir. 1926) (“This is not a tax directly imposed upon property, but more in the nature of an excise tax”). Accordingly, *Pollock*’s rule remains valid.

B. The “Fees” Charged by the PTO to Patent Applicants and Owners That Are Diverted Away From the PTO Are Not Fees but a Tax Because They Benefit the General Public and Exceed the Cost of Administering the Patent System

Fees that are collected from patent applicants and owners by the PTO and diverted into the general revenue are not “fees” but a tax. A number of cases decided in various contexts demonstrate that so-called fees are actually a tax if they are used to benefit the general public and exceed the cost of providing the relevant government services. These decisions unavoidably demonstrate that the diverted portion of the PTO fees constitutes a tax: (1) the diverted PTO fees benefit the general public by funding government programs unrelated to the patent system, and (2) because the PTO is completely underwritten by the collection of fees, the diverted portion of the fees must, by definition, exceed the cost of funding the PTO.

First, cases applying the Tax Injunction Act, a statute limiting the ability of federal courts to interfere with the collection of state taxes, have addressed the question of whether a given charge constitutes a tax rather than a fee. A key consideration in such cases is the use to which the collected funds were actually put: “if the ultimate use of the revenue benefits the general public then the charge will qualify as a ‘tax,’ while if the benefits are more narrowly circumscribed then the charge will more likely qualify as a ‘fee.’” *Valero Terrestrial Corp. v. Caffrey*, 205 F.3d 130, 134 (4th Cir. 2000). See generally *San Juan Cellular Telephone*

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Co. v. Public Services Commission, 967 F.2d 683 (1st Cir. 1992) (establishing framework for evaluating cases under the Tax Injunction Act). The fact that the revenue is placed in a special fund—such as the patent fee surcharge fund—is irrelevant. For “if the revenue of the special fund is used to benefit the population at large then the segregation of the revenue to a special fund is immaterial.” *Valero Terrestrial*, 205 F.3d at 135.

Courts have frequently determined that a particular charge constituted a tax under the Tax Injunction Act either because it was ultimately used for the general public benefit or because it was treated as general revenue. See, e.g., *American Landfill, Inc. v. Stark/Tuscarawas/Wayne Joint Solid Waste Mgmt. Dist.*, 166 F.3d 835, 839-40 (6th Cir. 1999) (holding that agency charge was a tax and noting that the particular fund, “while separate from the general revenue, serves public purposes benefiting the entire community”); *Home Builders Ass’n of Miss., Inc. v. City of Madison*, 143 F.3d 1006, 1011 (5th Cir. 1998) (“the classic tax sustains the essential flow of revenue to the government”); *Folio v. City of Clarksburg*, 134 F.3d 1211, 1217 (4th Cir. 1998) (“a tax is generally a revenue-raising measure, imposed by a legislative body, that allocates revenue to a general fund, and is spent for the benefit of the entire community”) (internal quotations and citation omitted); *Cumberland Farms, Inc. v. Tax Assessor*, 116 F.3d 943, 947 (1st Cir. 1997) (“the most salient factor in the decisional mix concerns the destination of the revenues raised by the impost”); *Travelers Ins. Co. v. Cuomo*, 14 F.3d 708, 713 (2d Cir. 1993), *rev’d on other grounds*, 514 U.S. 645 (1995) (“[n]otwithstanding the primary purposes ascribed to the surcharges by the State, both raise revenue which is ultimately paid into the State’s general fund”); *Miami Herald Publ’g Co. v. City of Hallandale*, 734 F.2d 666, 671 (11th Cir. 1984) (“license fee provisions . . . designed to raise revenue for the city” are taxes); *Robinson Protective Alarm Co. v. City of Philadelphia*, 581 F.2d 371, 376 (3d Cir. 1978) (charge is a tax because “moneys collected are added to the public fisc, rather than applied exclusively” to certain types of companies). Under this analysis, the portion of the PTO fees diverted to the general revenue and used for purposes that benefit the public must be a tax.

Second, the Supreme Court has held that payments to the government are only fees if they approximate the payer’s use of the system that the fees are exacted to fund and do not exceed the cost to the government of providing the benefits at issue. In *Massachusetts v. United States*, 435 U.S. 444 (1978), the Court addressed a flat charge imposed by the federal government on aircraft, including those owned by the state of Massachusetts. The state argued that the charge should be treated as a tax, rather than as a user fee, because it was a flat annual fee unrelated to the degree of use of the airways. *Id.* at 462. The Court rejected this argument under a test that required a valid user fee to be based on a fair approximation of the use of the system and to be structured to produce revenues that do not exceed the cost to the government of the benefits supplied. See *id.* at 466-67 (“So long as the charges . . . are based on a fair approximation of use of the system, and are structured to produce revenues that will not exceed the total cost to the Federal Government of the benefits to be supplied, there can be no substantial basis for a claim that the National Government will be using its taxing powers”). See also *Jorling v. Department of Energy*, 218 F.3d 96, 105 (2d Cir. 2000) (“as long as charges fairly approximate costs of available services, it does not matter whether or how a governmental entity segregates the money it collects”); *Brock v. Washington Metro. Area Transit Auth.*, 796 F.2d 481, 485 (D.C. Cir. 1986) (“the method used to calculate the fee must rationally be designed to approximate prospectively the benefit to the user”). Based on this precedent, the PTO fees that

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are diverted cannot possibly approximate the use of the patent system and must exceed the cost to the government of supplying the benefits of the patent system. That is, because the PTO is fully self-funding, the diversion of payments necessarily demonstrates that they are unnecessary to fund the PTO's operations.

In a similar vein, the Supreme Court held in *United States v. United States Shoe Corp.*, 523 U.S. 360 (1998), that a charge imposed on cargo shipped through American ports was a tax that violated the Export Clause of the Constitution. The Court rejected an argument that the charge was simply a user fee imposed to cover the cost of maintaining ports used by shippers. While this decision did not exempt exporters "from any and all user fees designed to defray the cost of harbor development and maintenance," it did require such fees to "fairly match the exporters' use of port services and facilities" and rejected the government's argument that an ad valorem tax provided an adequate approximation. *Id.* at 369-70 (internal quotations and citation omitted). Analogously, the diversion of a portion of the fees collected by the PTO demonstrates that the payments do not fairly match the use of PTO services by patent applicants and owners. For if the charges did approximate the use of the services, there would be no significant excess portion for Congress to divert.

Finally, in determining whether a state-imposed charge was a tax that violated the Commerce Clause, the Fourth Circuit developed a three-part test for deciding whether a payment was a tax or a user fee. See *Center for Auto Safety, Inc. v. Athey*, 37 F.3d 139 (4th Cir. 1994). The court defined a user fee as a charge that (1) reflects a fair, if imperfect, approximation of the cost of using state facilities; (2) does not discriminate against interstate commerce; and (3) is not excessive in relation to the costs incurred. See *id.* at 142 (citing *Evansville-Vanderburgh Airport Authority v. Delta Airlines, Inc.*, 405 U.S. 707, 717-720 (1972)). In particular, the court noted that the fees at issue were not excessive because "[t]he parties do not dispute that the total amount raised through registration fees did not exceed the funds necessary to cover [the state's] administration and enforcement of the Statute." *Id.* at 143. See also *USA Recycling, Inc. v. Town of Babylon*, 66 F.3d 1272, 1285 n.12 (2d Cir. 1995) ("Because it is undisputed that the Town uses all of the revenue from its user fees . . . to defray its expenses in providing [the services at issue], we cannot conclude that the amount of those assessments is 'manifestly disproportionate' to the benefits the Town confers in return" (citing *Evansville-Vanderburgh*, 405 U.S. at 719-20)). Under this test, the diverted PTO payments could be nothing but a tax: they do not approximate the cost of using the patent system, and they are by definition excessive in relation to the costs incurred in administering the PTO.

As a result, regardless of the line of cases used to determine the identity of the charges imposed by the PTO and diverted to the general revenue, that portion of the payments constitutes a tax. The unanimity of the results produced by these various modes of analysis makes this conclusion inescapable.

C. The Tax Imposed by the PTO is a Direct Tax Because a Patent, At All Its Stages, Is the Personal Property of Its Owner

Because a tax on personal property is a direct tax and the portion of payments to the PTO that is diverted to the general revenue is a tax, the diverted portion of the PTO charges must be unconstitutional if it is a tax on *property*. It is therefore necessary to identify the status

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of a patent at the time that application, issuance, and maintenance fees are paid. By way of background, when a person applies for a patent, he must pay an application fee to the PTO. *See* 35 U.S.C. § 41. After he receives a Notice of Allowance indicating that one or more claims of the application have been found to be patentable, *see* 37 C.F.R. § 1.311(a), he must pay an issuance fee to cause the PTO formally to issue the patent, *see* 37 C.F.R. § 1.314. Finally, after the patent has been issued, he must pay maintenance fees at fixed intervals to keep the patent fully enforceable in a civil action. *See* 37 C.F.R. § 1.362. At each of these three stages of the process, the patent—whether or not issued—constitutes the personal property of the applicant or owner.

Treating the stages of the patent process in reverse order, a patent is statutorily defined as personal property once it is issued. *See* 35 U.S.C. § 261 (“patents shall have the attributes of personal property”); *Patlex Corp. v. Mossinghoff*, 758 F.2d 594, 599 (Fed. Cir. 1985) (“It is beyond reasonable debate that patents are property”). Accordingly, any maintenance fees diverted to the general revenue constitute a tax on property. The issuance fee is also a tax on personal property, because at the point it is paid, the patent is all-but-issued. *See, e.g., GAF Bldg. Materials Corp. v. Elk Corp.*, 90 F.3d 479, 482 n.3 (Fed. Cir. 1996) (“it is not disputed that most applications in which the issue fee has been paid issue as patents”). For the PTO issues a Notice of Allowance only when “it appears that the applicant is entitled to a patent under the law.” 37 C.F.R. § 1.311(a). At this point, the PTO or the applicant can only withdraw the application for very limited reasons, *see* 37 C.F.R. § 1.313, and the PTO “will issue the patent in regular course unless the application is withdrawn from issue or the [PTO] defers issuance of the patent,” 37 C.F.R. § 1.314. In light of this structure, it would be a futile exercise in rigid formalism to argue that property rights in a patent do not vest until the moment it is granted.

Although the issue has not been adjudicated, an unissued patent should also constitute property of the applicant. A patent confers the right to exclude others from the use of an invention, which is “any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvements thereof.” 35 U.S.C. § 100. Congress has set forth the requirements governing the patentability of inventions, but when those requirements are met, an applicant “is entitled to a patent under the law.” 35 U.S.C. § 151. Thus, unlike systems that govern grants of licenses, which typically allocate scarce public resources, the patent system does not confer on the government discretion to deny a patent to an inventor entitled to one. *See* 35 U.S.C. § 131 (“The Director shall cause an examination to be made of the [patent] application and the alleged new invention; and if on such examination it appears that the applicant is entitled to a patent under the law, the Commissioner shall issue a patent therefor”). Indeed, the patent system is premised on the notion that a patent is not a gratuitous benefit bestowed unilaterally by the government, but a quid pro quo: in exchange for sharing an invention with the public, and thereby increasing the wealth of public knowledge, an inventor is awarded a limited monopoly on the practice of the invention. *See A. & E. Plastik Pak Co., Inc. v. Monsanto Co.*, 396 F.2d 710, 715 (9th Cir. 1968) (“a patent is a legal monopoly”). These factors demonstrate that an inventor actually possesses property at the time the patent application is filed; the issued patent does not itself create the property but rather perfects the inventor’s title.

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Accordingly, because (1) a tax on personal property is a direct tax, (2) the fees diverted from the PTO are a tax, and (3) a patent—whether issued or unissued—constitutes the personal property of the patent applicant or owner, Congress has imposed an unconstitutional direct tax by diverting funds collected by the PTO to the general revenue. Only by ceasing such diversion can Congress cure this violation of Article I, § 9.

